TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 151

THE UNITED STATES OF AMERICA, PETITIONER

vs.

JOLIET & CHICAGO RAILROAD COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR CERTIORARI FILED JUNE 10, 1941
CERTIORARI GRANTED OCTOBER 13, 1941

IN THE

United States Circuit Court of Appeals
For the Seventh Circuit

No. 7458

JOLIET & CHICAGO RAILROAD COMPANY,
Plaintiff-Appellant,

vs.

THE UNITED STATES OF AMERICA,
Defendant-Appellee.

Appeal from the District Court of the United States for the Northern District of Illinois, Eastern Division.

INDEX.

1 Pleas in the District Court of the United States for the Northern District of Illinois, Eastern Division, begun and held at the United States Court Room, in the City of Chicago, in said District and Division, before the Honorable Michael L. Igoe, District Judge of the United States for the Northern District of Illinois, on Thirteenth day of May, in the year of our Lord one thousand nine hundred and Forty, being one of the days of the regular May Term of said Court, begun Monday, the Sixth day of May, and of our Independence the 164th year. Placita.

Present:

Honorable Michael L. Igoe, District Judge.
William H. McDonnell, U. S. Marshal.
Hoyt King, Clerk.

2 IN THE DISTRICT COURT OF THE UNITED STATES,

Northern District of Illinois,

Eastern Division.

Joliet & Chicago Railroad Company, a corporation,
vs.
United States of America. } No. 692.

Be It Remembered, that the above-entitled action was commenced by the filing of the following Bill of Complaint in the above-entitled cause, in the office of the Clerk of the District Court of the United States, for the Northern District of Illinois, Eastern Division, on this the Nineteenth day of June, A. D. 1939.

Filed June 19, 1939. 3 IN THE DISTRICT COURT OF THE UNITED STATES.

* * (Caption—692) * *

BILL OF COMPLINT.

The plaintiff, Joliet & Chicago Railroad Company, a corporation, complains of the defendant, United States of America, and says:

1. The plaintiff is a corporation organized and existing under and by virtue of the laws of the State of Illinois.

2. This action is for the recovery of income taxes in the principal amount of $46,674.33, erroneously and illegally assessed and collected from plaintiff under the Internal Revenue laws of the United States.

3. On January 1, 1864 plaintiff, being then the owner of thirty-seven miles of railroad between the cities of Joliet and Chicago, in the State of Illinois, demised the same, together with all appurtenances thereof, without reservation, unto the Chicago and Alton Railroad Company, its successors and assigns forever, upon the terms and conditions contained and set forth in an indenture executed between the parties on said date (a true and correct copy of said indenture being hereto attached, marked "Exhibit A", and hereby made a part hereof).

4. It is provided in and by said indenture as follows:

4 "And the said party of the second part (said Chicago and Alton Railroad Company) hereby further covenants and agrees, to and with the said party of the first party (the plaintiff herein) that it, the said party of the second part, will guarantee and pay unto the holders of the shares of all the capital stock of the party of the first part, whether new or old, amounting to fifteen thousand shares, an annual dividend of seven per centum upon the par value of said shares of capital stock, and the said party of the second part further covenants and agrees that it will pay said dividend quarterly, in equal installments, on the first Monday in April, July, October and January, hereafter.

"And the said party of the second part hereby further covenants and agrees, to and with the said party of the first part, that for the purpose of paying the dividend hereinbefore agreed to be paid by said party of the second part, upon the capital stock of the party of the first part, it, the said party of the second part, will, on the first day of Febraury, A. D. 1864, and on the first day of each and every month thereafter, deposit in the custody of the United States Trust Company of the city and State of New York, the sum of eight thousand seven hundred and fifty dollars in funds bankable and current in said city of New York. Each and all of which deposits so made shall be placed, by the United States Trust Company, to the credit of the stockholders of the party of the first part, as a fund for the purpose of paying to said stockholders, or to their legal representatives or assigns, the dividends hereinbefore provided to be paid quarterly to them in accordance with the covenants hereinbefore set forth and contained.

"• • •

"And the said party of the second part further covenants and agrees, to and with the said party of the first part, that the said sums of money, to be monthly deposited as aforesaid with the United States Trust Company or other depositary in New York City, shall be free of all Federal taxes which are now or may hereafter be levied by the Government of the United States, upon the payment of dividends declared or made upon the capital stock of incorporated companies, and that the dividend

hereinbefore provided to be paid by the said party of the second part upon the capital stock of the party of the first part, shall be paid in full and without any deduction therefrom for any Federal tax whatsoever upon the payment of said dividend, and that all taxes which may at any time hereafter be due to the United States Government on account of said dividends so paid from time to time, shall be paid by the said party of the second part to the United States Government. Provided, nevertheless, and it is distinctly understood and agreed between the parties hereto, that any and all sums of money which may from time to time be allowed and paid by the depositors hereinbefore mentioned for and on account of interest allowed upon the sums of money deposited with it as aforesaid, shall be the property of and subject to the control and disposal of the said party of the second part."

5. The Alton Railroad Company, an Illinois corporation, as assignee of the purchasers thereof, acquired title on July 18, 1931, to the railroad and properties formerly owned by said The Chicago and Alton Railroad Company, said purchasers having acquired such title pursuant to a sale thereof ordered by this court in proceedings in equity entitled "The Texas Company *vs.* The Chicago and Alton Railroad Company", designated as Cause No. 2940. Said The Alton Railroad Company, as such assignee, entered into possession of said properties July 19, 1931, and has since that time been in possession of and operated the same, including the properties demised by the plaintiff as aforesaid under said indenture of January 1, 1864.

6. The said indenture is in form a perpetual lease and contains no provision or condition upon which the same may be terminated by the plaintiff in the event of the failure on the part of The Chicago and Alton Railroad Company, its successors or assigns, to make payments to the holders of all the plaintiff's capital stock (in accordance with the provisions above set forth), or otherwise to carry out and execute the covenants contained in the said indenture. Plaintiff is advised and believes, and therefore alleges, that the said indenture effectively conveyed title in fee simple absolute to said The Chicago and Alton Railroad Company, its successors and assigns, and that by virtue thereof such title to properties formerly owned by it is now in said The Alton Railroad Company.

6 7. Said The Alton Railroad Company, from the date of its acquisition of said properties as aforesaid and during the subsequent calendar years, 1932, 1933 and 1934, paid to the plaintiff's stockholders amounts equal to annual dividends of $7 per share in quarterly instalments in the manner and on the dates as set forth in the foregoing provisions of said indenture.

8. Proceeding under the erroneous theory that Article 51 of Regulations 77 promulgated by the Secretary of the Treasury of the United States imposed such requirement, plaintiff filed an income tax return for the year 1931 on March 12, 1932, reflecting the amount of dividends paid to plaintiff's stockholders by said The Alton Railroad Company (and its predecessor) as income of the plaintiff for the year 1931 and taxable to it as such. Said The Alton Railroad Company paid for the plaintiff a tax of $12,600, computed on that premise for the year in question. Subsequently, on November 22, 1933, proceeding under the purported authority of Article 130 of said Regulations 77, an additional assessment of $1,512 was proposed by the Internal Revenue Agent in Charge, Baltimore, Maryland, on the theory that the amount of tax so paid for the plaintiff by said The Alton Railroad Company constituted additional taxable income to the plaintiff, and on January 8, 1934 such additional amount of $1,512, together with interest of $160.50, was paid by said The Alton Railroad Company for the plaintiff to J. Enos Ray, the then Collector of Internal Revenue at Baltimore, Maryland.

9. In like manner, for the calendar year 1932, plaintiff filed an income tax return on or about March 14,
7 1933 reflecting the same amount of payments to plaintiff's stockholders as had been shown for the year 1931 as rental income to the plaintiff. The consequent tax amounted to $14,437.50 and was paid for the plaintiff by said The Alton Railroad Company. A proposed deficiency, based on the same grounds as the deficiency of 1931, amounting to $1,985.16, was also proposed by said letter of November 22, 1933, and, together with interest of $91.62, was likewise paid January 8, 1934 to the said J. Enos Ray by said The Alton Railroad Company.

10. For the years 1933 and 1934 the plaintiff filed an income tax return on or before March 15th of the respective succeeding years, reflecting as its income for said calendar years, respectively, the amounts of payments to plaintiff's stockholders and of the income tax imposed

thereon as taxable income of the plaintiff. The resulting tax amounted to $16,422.66 for each of said years, and was paid for the plaintiff by said The Chicago and Alton Railroad Company.

11. Payment of said income taxes in accordance with the returns filed for the years 1932, 1933 and 1934, were made in quarterly instalments. The dates and amounts of such quarterly payments and the several collectors of Internal Revenue at Baltimore, Maryland, to whom they were paid, are as follows:

For the calendar year 1932:

Date:	Amount:	To whom paid:
On or before March 15, 1933	$ 3,609.38	Galen L. Tait
On or before June 15, 1933	3,609.38	Galen L. Tait
On or before Sept. 15, 1933	3,609.38	J. Enos Ray
On or before Dec. 15, 1933	3,609.36	J. Enos Ray
Total	$14,437.50	

For the calendar year 1933:

On or before March 15, 1934	$ 4,105.67	J. Enos Ray
On or before June 15, 1934	4,105.67	J. Enos Ray
On or before Sept. 15, 1934	4,105.67	Lewis H. Melbourne (Acting Collector)
On or before Dec. 15, 1934	4,105.65	Lewis H. Melbourne (Acting Collector)
Total	$16,422.66	

8 For the calendar year 1934:

On or before March 15, 1935	$ 4,105.67	Lewis H. Melbourne (Acting Collector)
On or before June 15, 1935	4,105.67	Lewis H. Melbourne (Acting Collector)
On or before Sept. 15, 1935	4,195.67	Lewis H. Melbourne (Acting Collector)
Total	$12,317.01	

The term of office of said collector, Galen L. Tait, terminated on July 4, 1933, of said collector J. Enos Ray on September 10, 1934, and of said acting collector Lewis H. Melbourne on September 17, 1935.

12. On June 13, 1935 plaintiff filed claims for refund of the additional assessment of $1,512 paid for the year 1931, and for the full amount of the taxes paid for the year 1932 and 1933, in each case with interest thereon, with the Collector of Internal Revenue at Baltimore, Maryland. The same were rejected by letter of the Commissioner of Internal Revenue dated June 21, 1937. Plaintiff also filed on April 27, 1936 a claim for refund of the tax so paid for the year 1934, with interest, with the Collector of Internal Revenue at Baltimore, Maryland. Such claim was rejected by letter of the Commissioner of Internal Revenue dated July 13, 1937.

13. The assessment and collection of the aforesaid amounts of tax aggregating $46,674.33, together with interest on said deficiencies aggregating $252.12, was not warranted under any proper construction of the Revenue Acts of 1928, 1932 and 1934, or of the Regulations promulgated pursuant thereto, since the payments made by The Alton Railroad Company to the plaintiff's stockholders did not constitute rental paid even constructively to the plaintiff, nor income either actual or constructively received by it. Plaintiff, in fact, had no income, actual or constructive, for the years 1931 to 1934, inclusive. Said The Alton Railroad Company operated at a loss during each of said years, and the properties demised by said indenture were also operated at a loss, so that the
9 payments made to plaintiff's stockholders were made by said The Alton Railroad Company solely by reason of the guaranty contained in said indenture and not out of any earnings derived from said demised property.

14. The assessment and collection from plaintiff of the aforesaid amounts aggregating $46,674.33 was contrary to and in violation of the fifth amendment to the Constitution of the United States, in that such assessment and collection deprived plaintiff of property without due process of law, and such assessment and collection were also contrary to and in violation of plaintiff's rights under the statutes of the United States and under the other provisions of the said Constitution.

15. The said income taxes and interest in the aforesaid

amounts aggregating $46,926.45, were erroneously collected from plaintiff, and defendant became and is bound by law to pay to plaintiff in said amount of $46,926.45, with interest at the rate of 6% per annum on said several items thereof, from the dates respectively set forth below to a date not less than thirty days prior to payment thereof:

Amount:	Dates Interest Commences To Run:
$3,609.38	March 15, 1933
3,609.38	June 15, 1933
3,609.38	September 15, 1933
3,609.36	December 15, 1933
1,672.50	January 8, 1934
2,076.78	January 8, 1934
4,105.67	March 15, 1934
4,105.67	June 15, 1934
4,105.67	September 15, 1934
4,105.65	December 15, 1934
4,105.67	March 15, 1935
4,105.67	June 15, 1935
4,105.67	September 15, 1935

16. Defendant, though often requested, has not paid plaintiff the amount so paid by it, or any part thereof, but has altogether refused, and still refuses, to pay the same, or any part thereof.

Wherefore, plaintiff prays judgment for $46,926.45, with interest at the rate of 6% per annum on the various items aggregating said amount, computed as set forth in paragraph 15 above, together with the costs of this action.

Joliet & Chicago Railroad Company,
By Silas H. Strawn,
Frank H. Towner,
Arthur D. Welton, Jr.,
Its Attorneys.

Silas H. Strawn,
Frank H. Towner,
Arthur D. Welton, Jr.,
Attorneys for plaintiff.

11 State of Illinois, } ss.
County of Cook. }

H. L. Stuntz, being first duly sworn, on oath deposes and says that he is Assistant Comptroller of the plaintiff in the foregoing complaint; that he has read the above and foregoing complaint; that he is familiar with the facts therein set forth and that the same are true in substance and in fact, except as to matters alleged to be on information and belief, and as to those matters he believes them to be true.

H. L. Stuntz,

Subscribed and sworn to before me this 19th day of June, 1939.

Rose M. Leoni,
(Seal) *Notary Public.*

12 EXHIBIT A.

Joliet & Chicago Rail Road Company

to

Chicago & Alton Rail Road Company

Lease

This Indenture made and entered into this first day of January, in the year of our Lord One thousand eight hundred and sixty four, by and between The Joliet and Chicago Rail Road Company, the proprietor and owner of thirty seven miles of Rail-Road, between the Cities of Joliet and Chicago, in the state of Illinois, party of the first part, and the Chicago, and Alton Railroad Company, the proprietor and owner of two hundred, and twenty miles between the Cities of Joliet and Alton, in the State of Illinois party of the second part.

Witnesseth; that the said party of the first part, for and in consideration of the rents covenants and agreements, hereinafter contained and set forth, on behalf of the said party of the second part, its successors and assigns, to be paid kept and performed, hath granted demised and leased, and by these presents doth grant demise and lease, unto

the said party of the second part, and its successors and assigns, all and singular the Rail Road, Rail Road Track; Station Houses Water-Stations, Depots, Depots-Grounds, Engine-Houses, and Structures, of every kind whatsoever belonging to the said party of the first part, together with all and singular, the Locomotive Engines and Cars of every description, whatsoever, of which said party of the first part may now be possessed.

To have and to hold, the said above demised and
13 leased premises, together with all the appurtenances thereof without reservation, unto the said party of the second part, and to its successors and assigns from and after the First day of January in the year of our Lord one thousand eight hundred, and sixty four Forever, upon the terms and conditions hereinafter contained and set forth.

And the said party of the second part, for itself its successors and assigns, hereby covenants, and
(5 cts u st) agrees to and with the said party of the first
( ) part, that it, the said party of the second
(stamp) part, will forever, use and operate the said demised and leased premises, as a part of the main line of the Chicago and Alton Railroad.

And the said party of the second part for itself it successors and assigns, hereby further covenants and agrees to and with the said party of the first part, that it the said party of the second part, will at all times hereafter, at its own proper cost and expense, keep in good and sufficient repair, and in good working order, the Rail Road belonging to said party of the first part, together with the Rail Road Track, bridges fences, stations, depots, water tanks, and appurtenances thereof and that it, the said party of the second part, will at its own proper cost maintain the same, in such condition as it, the said party of the second part, shall deem necessary to ensure the efficiency thereof and for the convenient, and speedy dispatch of the ordinary railway, traffic over the same, and that for this purpose, the said party of the second part, will make all needful and proper repairs thereto, including the renewal of the track of said Rail Road, and all repairs and re-
14 newals of every kind whatsoever, which may from time to time be rendered necessary by reason of the wear and tear, of said Rail Road, and its appurtenances, and which may be necessary, to secure the prompt and efficient dispatch of the ordinary business which may at

any time hereafter be transacted upon said Rail Road. And the said party of the first part, as a further consideration to the said party of the second part, for the execution of this Lease, hereby covenants, and agrees, that it, the said party of the first part, on or before the first day of January A. D. 1864 will pay to the said party of the second part, the sum of Five hundred thousand dollars, which said sum of Five hundred thousand dollars may be paid to the said party of the second part, by the delivery to the said party of the second part, on or before the said first day of January A. D. 1864 of Five thousand new shares of the capital stock of the said party of the first part of the par value, of one hundred dollars each, issued by said party of the first part, in accordance with the terms, and provisions of its act of Incorporation.

And the said party of the first part hereby further agrees to and with the said party of the second part, that it, the said party of the first part, will not at any time hereafter make any further issue of its capital stock, then the issue hereinbefore provided to be made, and that the said party of the first part, will not at any time hereafter, execute any Mortgage or trust deed, upon the property herein before demised, and leased to the said party of the second part, and that it the said party of the first part, will not at any time hereafter issue any bonds secured, in any manner by any pledge or mortgage, upon the said demised premises.

And the said party of the second part for the considerations aforesaid, for itself, its successors, and assigns, hereby further, covenants and agrees to and with the said party of the first part, that it, the said party of the second part will assume and pay the annual interest, upon the bonds heretofore issued, by the said party of the first part, and which may be at this time outstanding uncancelled, the said bonds being Five hundred in number, each for the sum of One thousand dollars, bearing interest, payable semi annually, at the rate of eight per centum per annum, at the Continental Bank in New York City, and secured by a deed of trust, executed on the first day of July A. D. 1857 by the party of the first part, to Luther C. Clark. And the said party of the second part hereby further agrees, to and with the said party of the first part, that it, the said party of the second part, will assume and pay the principal of the Bonds of the party of the first part herein-

before specified, when the same shall become due, and payable, and that it, the said party of the second part, will at all times hereafter carefully observe, and keep the conditions and agreements, contained in the trust deed, hereinbefore mentioned, on behalf of the party of the first part, so far as the said conditions, are designed and intended to secure the payment of the principal of interest of said bond. And the said party of the second part, hereby further covenants and agrees, to and with the said party of the first part, that it the said party of the second part, will guarantee and pay, unto the holders of the shares of
16 all the capital stock of the party of the first part, whether new or old, amounting to Fifteen thousand shares, an annual dividend of seven per centum, upon the par value of said shares of capital Stock, and the said party of the second part, further covenants and agrees, that it will pay the said dividend, quarterly in equal installments, on the first Monday in April, July, October and January hereafter. And the said party of the second part hereby further covenants and agrees, to and with the said parties of the first part, that for the purpose of paying the dividend, herein before agreed, to be paid by said party of the second part, upon the capital Stock of the party of the first part, it, the said party of the second part, will on the first day of February A. D. 1864 and on the first day of each and every month hereafter, deposit in the custody of the United States Trust Company of the State of New York, the sum of Eight thousand seven hundred and fifty dollars in funds, bankable and current in said City of New York, each and all of which deposits so made shall be placed by the said United States Trust Company to the Credit of the Stockholders of the party of the first part, as a fund for the purpose of paying to said Stockholders, or to their legal representatives or assigns the dividends herein before, provided to be paid quarterly to them in accordance, with the covenants herein before set forth and contained.

And it is hereby mutually agreed between the parties hereto, that if at any time hereafter the said United States Trust Company shall cease to exist, or shall become an unsafe depository of the funds hereinbefore agreed to be deposited with it, or shall refuse to receive the said
17 deposits, then in either of said cases the Board of Directors of the party of the first part and the Board of

Directors of the party of the second part, acting together, shall select and designate a depository of said funds, and the said funds shall be paid into the depository so selected and designated. And the said party of the second part further covenants and agrees to and with the said party of the first part, that the said sums of money to be monthly deposited as aforesaid, with the United States Trust Company or other depository, in New York City, shall be free of all federal taxes which are now or may hereafter be levied by the Government of the United States, upon the payment of dividends, declared or made upon the capital Stock of incorporated companies, and that the dividend hereinbefore provided to be paid by the said party of the second part upon the capital stock of the party of the first part, shall be paid in full, and without any deduction therefrom for any federal tax whatsoever, upon the payment of said dividend, and that all taxes which may at any time hereafter be due, to the United States Government on account of said dividend so paid from time to time, shall be paid by the said party of the second part to the United States Government. Provided nevertheless, and it is distinctly understood and agreed between the parties hereto, that any and all sums of money which may from time to time, be allowed and paid by the depositary herein before mentioned, for and on account of interest allowed upon the sums of money deposited with it as aforesaid, shall be the property of, and subject to the control and disposal of the said party of the second part.

(5 cts. u.)
(states)
(stamps)

And the said party of the second part for the consideration aforesaid hereby further agrees to and with the said party of the first part, that it, the said party of the second part, will at all times hereafter pay all taxes, whether federal, State, County or municipal, which are or may hereafter, be assessed against the premises hereinbefore demised, and leased at the time, when said taxes may be due and payable.

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And the said party of the second part for the consideration aforesaid, and for the purpose of further securing and guaranteeing, to the said party of the first part, the faithful performance of all and singular the covenants and agreements herein contained, on the part and behalf of the said party of the second part, to be performed and kept, hereby expressly pledges, to the said party of the first

part, thirty seven parts out of two hundred and fifty seven parts of the gross receipts of the line of Rail Road, between the Cities of Alton and Chicago, which is formed by the two lines of Rail Road herein before mentioned. And the said party of the second part, for the purpose of ascertaining the said thirty seven two hundred and fifty sevenths of the Gross Receipts so pledged as aforesaid, and for the purpose of further securing to the party of the first part, the performance of the covenants and agreements herein contained to be performed and kept on the part and behalf of said party of the second part hereby covenants, and agrees, to and with the said first party, that it the said party of the second part will keep a true and accurate account of the gross receipts of the line of rail Road between the Cities of Chicago and Alton, and that it will at the end of each and every month hereafter, and within twenty days thereafter, make up and ex-
19 hibit to the proper officers of the said party of the first part, a true and correct statement of said gross receipts for that month.

And the said party of the second part, hereby further covenants and agrees, to and with the said party of the first part, that at the end of each and every month, in the year, and within twenty days thereafter, it, the said party of the second part, will divide the amount of the gross receipts for that month as shown by the statement, hereinbefore provided for, into two hundred, and fifty seven equal shares, equalling the number of miles of Rail Road to be operated by the said party of the second part under this agreement, and that it, the said party of the second part will cause thirty seven parts of the two hundred and fifty seven parts, so ascertained, to be placed to the Credit of said party of the first part, upon the books of account of the party of the second part, and that these thirty seven equal parts, shall be by said party of the second part specially retained and reserved, as a fund pledged for the purpose of securing and guaranteeing to the said party of the first part the performance of the covenants and agreements herein contained on behalf of the party of the second part, so far as the same shall relate to the maintainance and repair of its Rail Road, and appurtenances the payment of the semi-annual interest, upon the outstanding Bonds of the party of the first part, and the monthly deposit of the sums of money herein before provided to be made by the party of the second part, for the purpose of paying the quarterly dividends, upon the shares

of the Capital stock of the party of the first part. And
20 the said party of the second part further agrees to and with the said party of the first part that in case the amount herein provided, to be placed monthly to the credit of the said party of the first part, upon the books of account of the party of the second part, shall at the end of any month hereafter be insufficient to pay the said party of the first part the full amount herein agreed to be paid or secured by said party of the second part during that month, as also the proportionate part for that month of the quarterly dividend herein agreed to be paid by said party of the second part, and the proportionate part for that month of the semi-annual interest to be paid by said party of the second part, upon the outstanding bonds, of said party of the first part, then and in that case, any deficiency which may so arise, by reason of thirty seven two hundred and fifty seventh of the gross receipts, of the line of Rail Road, between Chicago and Alton being insufficient to secure and cover the monthly proportion of all the payments herein before provided to be paid by the party of the second part, shall be made up and supplied by the further assignment and Credit to the said party of the first part, upon the books of account of said party of the second part of so much of its receipts, in addition to that already assigned and credited as may be necessary to supply the deficiency. And it is hereby mutually agreed between the parties hereto, that the end of each and every six month hereafter or as soon as the same can be reasonably done an account shall be taken, of the amounts paid by said party of the second part, during said six month in accordance with the covenants and agreements herein contained and the amount
21 of said payments shall be ascertained and on account shall also at the same time be taken of the amounts credited at the end of each and every month, during said sixth month to the party of the first part in accordance with the provisions hereof, and the amount of said Credits shall be computed and ascertained, and if at the time of making said computations, it shall be found that the amount of the credits, so made during said six month, shall exceed the amount of the payments made or to be made, by said party of the second part, during said period of sixth month, then the excess so ascertained, shall be restored to the said party of the second part, upon its books of account, the proper entries being made therein for that purpose and as to said

excess the lien of the party of the first part upon the same herein before provided for, shall be satisfied and discharged. And the said party of the second part hereby further covenants and agrees to and with said party of the first part that the said party of the first part for the purpose of verifying the accounts herein provided to be rendered by said party of the second part shall at all proper times by its president or any person appointed by him for that purpose, have access to the books of account and vouchers of the said party of the second part. And the said party of the second part hereby further covenants, and agrees, to and with the, said party of the first part, that it, the said party of the second part, will at all times hereafter guarantee and indemnify the said party of the first part, against all claims for damage growing out of the operation of the said line of Rail Road between the Cities of Chicago and Alton, and that it the said party of the second part, will pay and
22 satisfy all damages, which may be assessed against either of the parties hereto, growing out of the operation of said line of Rail Road, whether the same be founded upon claims for non performance of duty as common carriers of passengers or freight, injuries to cattle or other animals, along the line of said Rail Road losses arising from fires communicated along said line of Rail Road from the locomotive engines used thereon, or from any other cause occurring hereafter by the negligence or dereliction of duty of the party of the second part in the conduct of the business and traffic of said line of railroad. And the said party of the second part, hereby agrees to and with the said party of the first part, that it the said party of the second part, will hereafter pay the salaries of the following officers, of the parties of the first part, namely; The President of the said Joliet and Chicago Rail Road Company the secretary thereof, and the transfer Agent of said Company in New York City, provided that the aggregate amount of the annual salaries of said officers shall not exceed the sum of two thousand dollars, and that it the said party of the second part, will also pay to the United States Trust Company or other depository in the City of New York, the annual charge made by such depository for the registration of the shares of the capital stock of the said party of the first part, and the payment of the quarterly dividends thereon, hereinbefore provided to be paid. And it is mutually agreed between the parties hereto, that if at any time hereafter, any

disagreement shall arise between the parties
(stamp) hereto as to the construction of any of the
(5 cts. u.st) articles of this agreement, and which said disagreement, cannot be adjusted and settled between, the respective officers of the two corporations,
23 parties hereto, or in any case any question should hereafter arise between the parties hereto, as to the nonfulfillment of any of the agreements, and covenants herein contained, then in all such cases the questions, so arising, shall be submitted to the arbitration of two disinterested persons, skilled in the business of conducting and managing Rail Roads, one of whom shall be chosen by each of the parties hereto, and the said arbitrators so chosen shall have authority and power to make a final decision, and adjustment of such questions and their decision when so made shall be final, and conclusive of the matters and things so determined. And it is further mutually agreed, between the parties hereto, that in case the arbitrators so chosen as aforesaid shall fail to agree upon the adjustment of the question or questions so submitted to them as aforesaid then in such case the two arbitrators, shall choose an umpire, who shall be a disinterested person, skilled in the conduct of Rail Roads, and the award of the umpire so chosen, when made, shall be conclusive as to the questions decided by him.

And it is further mutually agreed, between the parties hereto, that in case the arbitrators chosen, by the parties hereto as aforesaid, shall within ten days, after any disagreement upon a question submitted to them in pursuance, of this agreement, fail to select an umpire as herein provided, then and in that case each of the parties, hereto shall name a person, and from the two persons so named, an umpire shall be selected by drawing lots, who shall have like powers and authority, and whose decision shall be equally binding upon the parties hereto, as though he had been selected by the arbitrators, in the manner herein
24 provided for. And it further mutually agreed, between the parties hereto, that if at any time either of said parties, after ten days notice in writing so to do, shall fail to name an umpire to be selected by lot, in the manner herein before provided for, then and in that case, the person selected by the other party shall be authorized and empowered to act as umpire and his decision of the question submitted to him, shall be final and conclusive between the parties hereto.

(Seal) (Corporate) (Seal) (Corporate) In Witness whereof the parties have caused these presents to be sealed with their respective corporate Seals and to be signed by their respective presidents and Secretaries on this first day of January, in the year of our Lord one thousand eight hundred and sixty four.

Joseph Price,
Secretary of the Joliet & Chicago Rail Road Company.

Joseph Price,
Secretary of the Chicago and Alton Railroad Company.

The words "of the party of the first part" on page two line 30, and the words "hereby covenants and agrees, to and with the said first party that it, the said party of the second part" on page 3 line 34 and the words "and the proportionate part for that month of the semi-annual interest, to be paid by said party of the second part" on page 4, line 13, and the word "so" on page 4, line 14, and word hereafter, on page 4, line 22, interlined in this agreement before signing the same. The word three on page one (1) line three (3) was altered to fore in this agreement, before signing the same.

T. B. B. *Prest.*

T. B. Blackstone,
Prest., Joliet & Chicago Rd. Co.

Sam Robb,
President of the Chicago & A. R. R. Co.

25 And on, to wit, the 19th day of June, 1939, came the Joliet & Chicago Railroad Company, Plaintiff, by its attorneys and filed in the Clerk's office of said Court its certain Complaint in the case of Joliet & Chicago Railroad Company *vs.* United States of America, No. 693, in words and figures following, to wit:

26 IN THE DISTRICT COURT OF THE UNITED STATES. Filed June 19, 1939.
* * (Caption—693) * *

BILL OF COMPLAINT.

The plaintiff, Joliet & Chicago Railroad Company, a corporation, complains of the defendant, United States of America, and says:

1. The plaintiff is a corporation organized and existing under and by virtue of the laws of the State of Illinois.

2. This action is for the recovery of income taxes in the principal amount of $4,105.65, erroneously and illegally assessed and collected from plaintiff under the Internal Revenue laws of the United States.

3. On January 1, 1864 plaintiff, being then the owner of thirty-seven miles of railroad between the cities of Joliet and Chicago, in the State of Illinois, demised the same, together with all the appurtenances thereof, without reservation, unto the Chicago and Alton Railroad Company, its successors and assigns forever, upon the terms and conditions contained and set forth in an indenture executed between the parties on said date (a true and correct copy of said indenture being hereto attached, marked "Exhibit A", and hereby made a part hereof).

4. It is provided in and by said indenture as follows:

27 "And the said party of the second part (said Chicago and Alton Railroad Company) hereby further covenants and agrees, to and with the said party of the first part (the plaintiff herein) that is, the said party of the second part, will guarantee and pay unto the holders of the shares of all the capital stock of the party of the first part, whether new or old, amounting to fifteen thousand shares, an annual dividend of seven per centum upon the par value of said shares of capital stock, and the said party of the second part further covenants and agrees that it will pay said dividend quarterly, in equal installments, on the first Monday in April, July, October and January, hereafter.

"And the said party of the second part hereby further covenants and agrees, to and with the said party of the first part, that for the purpose of paying the dividend hereinbefore agreed to be paid by said party of the second part, upon the capital stock of the party of the first part, it, the

said party of the second part, will, on the first day of February, A. D. 1864, and on the first day of each and every month thereafter, deposit in the custody of the United States Trust Company of the city and State of New York, the sum of eight thousand seven hundred and fifty dollars in funds bankable and current in said city of New York. Each and all of which deposits so made shall be placed, by the United States Trust Company, to the credit of the stockholders of the party of the first part, as a fund for the purpose of paying to said stockholders, or to their legal representatives or assigns, the dividends hereinbefore provided to be paid quarterly to them in accordance with the covenants hereinbefore set forth and contained.

" * * * * * *

"And the said party of the second part further covenants and agrees, to and with the said party of the first part, that the said sums of money, to be monthly deposited as aforesaid with the United States Trust Company or other depository in New York City, shall be free of all Federal taxes which are now or may hereafter be levied by the Government of the United States, upon the payment of dividends declared or made upon the capital stock of incorporated companies, and that the dividend hereinbefore provided to be paid by the said party of the second part upon the capital stock of the party of the first part, shall be paid in full and without any deduction therefrom for any Federal tax whatsoever upon the payment of said dividend, and that all taxes which may at any time hereafter be due to the United States Government on account of said dividends so paid from time to time, shall be paid by the said party of the second part to the United States Govern-
28 ment. Provided, nevertheless, and it is distinctly understood and agreed between the parties hereto, that any and all sums of money which may from time to time be allowed and paid by the depository hereinbefore mentioned for and on account of interest allowed upon the sums of money deposited with it as aforesaid, shall be the property of and subject to the control and disposal of the said party of the second part."

5. The Alton Railroad Company, an Illinois corporation, as assignee of the purchasers thereof, acquired title on July 18, 1931, to the railroad and properties formerly owned by said The Chicago and Alton Railroad Company, said purchasers having acquired such title pursuant to a sale thereof ordered by this court in proceedings in equity en-

titled "The Texas Company *vs.* The Chicago and Alton Railroad Company", designated as Cause No. 2940. Said The Alton Railroad Company, as such assignee, entered into possession of said properties July 19, 1931, and has since that time been in possession of and operated the same, including the properties demised by the plaintiff as aforesaid under said indenture of January 1, 1864.

6. The said indenture is in form a perpetual lease and contains no provision or condition upon which the same may be terminated by the plaintiff in the event of the failure on the part of The Chicago and Alton Railroad Company, its successors or assigns, to make payments to the holders of all the plaintiff's capital stock (in accordance with the provisions above set forth), or otherwise to carry out and execute the covenants contained in the said indenture. Plaintiff is advised and believes, and therefore alleges, that the said indenture effectively conveyed title in fee simple absolute to said The Chicago and Alton Railroad Company, its successors and assigns, and that by virtue thereof such title to properties formerly owned by it is now in said The Alton Railroad Company.

29 7. Said The Alton Railroad Company, from the date of its acquisition of said properties as aforesaid and during subsequent calendar years, including the year 1934, paid to the plaintiff's stockholders amounts equal to annual dividends of $7 per share in quarterly instalments in the manner and on the dates as set forth in the foregoing provisions of said indenture.

8. For the year 1934 the plaintiff filed an income tax return on or about March 14, 1935, reflecting as its income for such year the amounts of payments to plaintiff's stockholders and of the income tax imposed thereon as taxable income of the plaintiff. The resulting tax amounted to $16,422.66 for such year, and was paid in quarterly instalments by said The Chicago and Alton Railroad Company. The final instalment, amounting to $4,105.65, was paid to M. Hampton Magruder, then and now Collector of Internal Revenue at Baltimore, Maryland.

9. Plaintiff filed on April 27, 1936 a claim for refund of the tax so paid for the year 1934, with interest, with the Collector of Internal Revenue at Baltimore, Maryland. Such claim was rejected by letter of the Commissioner of Internal Revenue dated July 13, 1937.

10. The assessment and collection of the aforesaid tax of $4,105.65 was not warranted under any proper construc-

tion of the Revenue Act of 1934, or of the Regulations promulgated pursuant thereto, since the payments made by The Alton Railroad Company to the plaintiff's stockholders did not constitute rental paid even constructively to the plaintiff, nor income either actually or constructively received by it. Plaintiff, in fact, had no income, actual or constructive, for the year 1934. Said The Alton Railroad Company operated at a loss during the year 1934, and the properties demised by said indenture were also operated at a loss, so that the payments made to plaintiff's stockholders during that year were made by said The Alton Railroad Company solely by reason of the guarantee contained in said indenture and not out of net earnings derived from said demised property.

11. The assessment and collection from plaintiff of the aforesaid amount of $4,105.65 was contrary to and in violation of the fifth amendment to the Constitution of the United States, in that such assessment and collection deprived plaintiff of property without due process of law, and such assessment and collection were also contrary to and in violation of plaintiff's rights under the statutes of the United States and under the other provisions of the said Constitution.

12. The said income taxes in the amount of $4,105.65 were erroneously collected from plaintiff, and defendant became and is bound by law to pay to plaintiff in said amount of $4,105.65, with interest at the rate of 6% per annum on said item, from December 15, 1935 to a date not less than thirty days prior to payment thereof.

13. Defendant, though often requested, has not paid plaintiff the amount so paid by it, or any part thereof, but has altogether refused, and still refuses, to pay the same, or any part thereof.

Wherefore, plaintiff prays judgment for $4,105.65, with interest thereon at the rate of 6% per annum, computed as set forth in paragraph 12 above, together with the costs of this action.

Joliet & Chicago Railroad Company,
By Silas H. Strawn,
Frank H. Towner,
Arthur D. Welton, Jr.,
Its Attorneys.

Silas H. Strawn,
Frank H. Towner,
Arthur D. Welton, Jr.,
Attorneys for Plaintiff.

31 State of Illinois, } ss.
County of Cook. }

H. L. Stuntz, being first duly sworn, on oath deposes and says that he is Assistant Comptroller of the plaintiff in the foregoing complaint; that he has read the above and foregoing complaint; that he is familiar with the facts therein set forth, and that the same are true in substance and in fact, except as to matters alleged to be on information and belief, and as to those matters he believes them to be true.

H. L. Stuntz.

Subscribed and sworn to before me this 19th day of June, 1939.

Rose W. Levin,
(Seal) *Notary Public.*

(Exhibit "A" hereto follows. Not copied.)

32 And on, to wit, the 23rd day of September, 1939, came the Defendant in case No. 692 by its attorneys and filed in the Clerk's office of said Court its certain Answer in words and figures following, to wit: Filed Sept. 23 1939.

33 In the District Court of the United States.
* * (Caption—692) * *

ANSWER.

Comes now the defendant, United States of America, by its attorney, William J. Campbell, United States Attorney for the Northern District of Illinois, and in answer to the complaint herein filed admits, denies, and alleges as follows:

I.

Defendant admits the allegations of paragraph 1 of the complaint.

II.

Defendant admits the allegations of paragraph 2 of the complaint, except that the taxes sought to be recovered were erroneously and illegally assessed and collected.

III.

Answering paragraph 3 of the complaint, defendant admits that plaintiff was the owner of the railroad between Joliet and Chicago, Illinois, and that plaintiff entered into the agreement, a copy of which is marked "Exhibit A" and attached to the complaint. Defendant denies each and every other allegation contained in said paragraph.

IV.

Defendant admits the allegations of paragraph 4 of the complaint.

34

V.

Defendant does not have sufficient information to form an opinion as to the truth of the allegations of paragraph 5 of the complaint and therefore denies the same.

VI.

Defendant denies each and every allegation contained in paragraph 6 of the complaint.

VII.

Defendant admits the allegations contained in paragraph 7 of the complaint.

VIII.

Defendant admits that the Alton Railroad Company originally paid for the plaintiff an income tax of $12,600 for the year 1931 and an additional assessment of $15.12 which was assessed by the Commissioner on November 22, 1933, but denies each and every other allegation contained in paragraph 8 of the complaint.

IX.

Defendant admits the allegations contained in paragraphs 9, 10, 11 and 12 of the complaint.

X.

Defendant denies the allegations contained in paragraphs 13, 14 and 15 of the complaint.

XI.

Defendant admits the allegations contained in paragraph 16 of the complaint.

Wherefore, defendant denies that it is indebted to plaintiff in any amount or that plaintiff is entitled to judgment or any other relief prayed for.

35 As a further defense to said complaint, defendant alleges as follows:

I.

That the first installment of income taxes in the amount of $3,609.38 for the year 1932 was paid on March 15, 1933.

II.

That no claim for refund of the amount of taxes paid for the year 1932 was filed by the plaintiff prior to June 13, 1935.

III.

That Section 322 (b) of the Revenue Act of 1932, c. 209, 47 Stat. 169, provides as follows:

(b) Limitation of Allowance—

(1) Period of Limitation. No such credit or refund shall be allowed or made after two years from the time the tax was paid, unless before the expiration of such period a claim therefor is filed by the taxpayer.

(2) Limit on Amount of Credit or Refund. The amount of the credit or refund shall not exceed the portion of the tax paid during the two years immediately preceding the filing of the claim, or if no claim was filed, then during the two years immediately preceding the allowance of the credit or refund.

IV.

That by virtue of the above provision the first installment of income taxes in the amount of $3,609.38 for the year 1932, which was paid on March 15, 1933, cannot be refunded to the plaintiff as no claim for refund was filed within time.

William J. Campbell,
United States Attorney.

36 State of Illinois, } ss.
County of Cook. }

William J. Campbell, being first duly sworn, on oath deposes and says that he is a duly appointed and qualified United States District Attorney for the Northern District of Illinois, and that in such capacity he is one of the duly authorized representatives of the defendant herein; that he has read the foregoing answer and is familiar with the contents therein, and that the matters and things therein contained are true in substance and in fact.

William J. Campbell.

Subscribed and sworn to before me this 23rd day of September, A. D. 1939.

Anna L. Minahan,
(Seal) *Notary Public.*

State of Illinois, } ss.
County of Cook. }

Anna L. Minahan, being first duly sworn, on oath deposes and says that she is employed as Clerk in the office of the United States Attorney at Chicago, Illinois; that on September 23, 1939 she placed a copy of the above and foregoing answer in a Government franked envelope addressed to Winston, Strawn and Shaw, First National Bank Building, Chicago, Illinois, and deposited said envelope so addressed, and contained said copy of the foregoing Answer, in the United States Mail Chute, Chicago, Illinois.

Anna L. Minahan.

Subscribed and sworn to before me this 23rd day of September, A. D. 1939.

Charles A. Sistek,
(Seal) *Notary Public.*

37 And on, to wit, the 23rd day of September, 1939, came the Defendant in Case No. 693 by its attorneys and filed in the Clerk's office of said Court its certain Answer in words and figures following, to wit:

38 IN THE DISTRICT COURT OF THE UNITED STATES. Filed Sept. 2 1939.
• • (Caption—693) • •

ANSWER.

Comes now the defendant, United States of America, by its attorney, William J. Campbell, United States Attorney for the Northern District of Illinois, and in answer to the complaint herein filed admits, denies, and alleges as follows:

I.

Defendant admits the allegations of paragraph 1 of the complaint.

II.

Defendant admits the allegations of paragraph 2 of the complaint, except that the taxes sought to be recovered were erroneously and illegally assessed and collected.

III.

Answering paragraph 3 of the complaint, defendant admits that plaintiff was the owner of the railroad between Joliet and Chicago, Illinois, and that plaintiff entered into the agreement, a copy of which is marked "Exhibit A" and attached to the complaint. Defendant denies each and every other allegation contained in said paragraph.

IV.

Defendant admits the allegations of paragraph 4 of
39 the complaint.

V.

Defendant does not have sufficient information to form an opinion as to the truth of the allegations of paragraph 5 of the complaint and therefore denies the same.

VI.

Defendant denies each and every allegation contained in paragraph 6 of the complaint.

VII.

Defendant admits the allegations contained in paragraphs 7, 8 and 9 of the complaint.

VIII.

Defendant denies each and every allegation contained in paragraphs 10, 11 and 12 of the complaint.

IX.

Defendant admits the allegations contained in paragraph 13 of the complaint.

Wherefore, defendant denies that it is indebted to plaintiff in any amount or that plaintiff is entitled to judgment or any other relief prayed for.

William J. Campbell,
United States Attorney.

State of Illinois, }
County of Cook. } ss.

William J. Campbell, being first duly sworn, on oath deposes and says that he is a duly appointed and qualified United States District Attorney for the Northern District of Illinois, and that in such capacity he is one of the duly authorized representatives of the defendant herein; that he has read the foregoing Answer and is familiar with the contents thereof, and that the matters and things therein contained are true in substance and in fact.

William J. Campbell.

Subscribed and sworn to before me this 23rd day of September, A. D. 1939.

Anna L. Minahan,
Notary Public.

(Seal)

State of Illinois, }
County of Cook. } ss.

Anna L. Minahan, being first duly sworn, on oath deposes and says that she is employed as Clerk in the office of the United States Attorney at Chicago, Illinois; that on September 22nd, 1938, she placed a copy of the above and foregoing Answer in a Government franked envelop addressed to Winston, Strawn and Shaw, First National Bank Building, Chicago, Illinois, and deposited said envelop so addressed and containing said copy of the foregoing Answer, in the United States Mail Chute located on the 8th floor of the United States Courthouse, Chicago, Illinois.

Anna L. Minahan.

Subscribed and sworn to before me this 23rd day of September, A. D. 1939.

Charles A. Sistek,
Notary Public.

(Seal)

41 And afterwards, to wit, on the 1st day of March, A. D. 1940, being one of the days of the regular February term of said Court, in the record of proceedings thereof, in said entitled cause, before the Honorable Michael L. Igoe, District Judge, appears the following entry, to wit:

Entered Mar. 1, 1940.

42 IN THE DISTRICT COURT OF THE UNITED STATES,

Northern District of Illinois,

Eastern Division.

Joliet & Chicago Railroad Company, *Plaintiff,*
vs.
United States of America, *Defendant.*
} Civil Action No. 692.

Joliet & Chicago Railroad Company, *Plaintiff,*
vs.
United States of America, *Defendant.*
} Civil Action No. 693.

ORDER.

On stipulation of the parties hereto, herein filed by their respective attorneys, it is

Ordered that the above entitled cases be and they hereby are consolidated and shall be tried as one case.

Enter:

Igoe,
Judge.

Dated: March 1, 1940.

Filed Mar. 1, 1940.

43 And on, to wit, the 1st day of March, 1940, came the parties by their attorneys and filed in the Clerk's office of said Court their certain Stipulation of Facts in words and figures following, to wit:

44 IN THE DISTRICT COURT OF THE UNITED STATES.

* * (Captions—692-693) * *

STIPULATION OF FACTS.

It Is Hereby Stipulated, by and between the parties hereto, that the following facts may be taken as true to the same extent as if proved at trial, provided that nothing herein shall prevent either party from objecting to the

materiality of the facts herein stipulated or from introducing further evidence at the trial not inconsistent with the facts herein stipulated.

1. These are actions for the recovery of income taxes paid for the plaintiff for the years 1931 to 1934, inclusive.

2. The plaintiff, Joliet and Chicago Railroad Company, is a corporation organized and existing under and by virtue of the laws of the State of Illinois.

3. On January 1, 1864 the plaintiff, being then the owner of thirty-seven miles of railroad between the cities of Joliet and Chicago, in the State of Illinois, entered into an indenture with the Chicago and Alton Railroad Company under which it demised and leased the same, together with all of the appurtenances thereof, unto said The Chicago and Alton Railroad Company, its successors and assigns, upon the terms and conditions contained and set
45 forth in said indenture, a true and correct copy of said indenture is hereto attached, marked "Exhibit A", and hereby made a part hereof. Among other things said indenture provides:

"And the said party of the second part (said The Chicago and Alton Railroad Company) hereby further covenants and agrees, to and with the said party of the first part (the plaintiff herein) that it, the said party of the second part, will guarantee and pay unto the holders of the shares of all the capital stock of the party of the first part, whether new or old, amounting to fifteen thousand shares, an annual dividend of seven per centum upon the par value of said shares of capital stock, and the said party of the second part further covenants and agrees that it will pay said dividend quarterly, in equal installments, on the first Monday in April, July, October and January, hereafter."

4. The certificates of capital stock of the plaintiff contain the following provision on the face thereof:

"This Stock is limited to 15,000 Shares of One Hundred Dollars each and is issued in accordance with the 2nd Section of the Charter of this Company; it is perpetually guaranteed a Dividend of Seven per cent for each calendar year free of Government tax, payable quarter-annually on the 1st Monday in April, July, Oct. and Jany. th payment of which is secured by a Contract of Lease with the Chicago and Alton Railroad Company of the Railroad of this Company dated 1st January, 1864, the conditions of which are irrevocable and require a deposit monthly with the

United States Trust Company in the City of New York of $8,750, on account of said Dividend, and for the security of the punctual payment monthly of the above sum, 37 parts out of 257 parts of the gross receipts of the Chicago and Alton Railroad Company from the line of railroad between the Cities of Alton and Chicago, are perpetually pledged".

5. The Alton Railroad Company, an Illinois corporation (hereinafter referred to as "the Alton Company") acquired title on July 18, 1931 to the railroad and properties formerly owned by said The Chicago and Alton Railroad Company, including the interest in the said thirty-seven miles of railroad, created by said indenture of January 1, 1864. Such title was secured as assignee of the purchasers of said properties, said purchasers having acquired the same pursuant to a sale thereof ordered by this court in proceedings in equity entitled "The Texas Company *vs.*
The Chicago and Alton Railroad Company", desig-
46 nated as Cause No. 2040. Said The Alton Railroad
Company, as such assignee, entered into possession of said properties July 19, 1931, and since that time has been in possession of and operated the same, including the said thirty-seven miles of railroad between Joliet and Chicago, Illinois.

6. The Alton Company, from the date of its acquisition in 1931 of said properties as aforesaid (and prior thereto its predecessor) paid to the plaintiff's stockholders during the calendar years 1931, 1932, 1933 and 1934 amounts equal to annual dividends of $7 per share ($105.000) in quarterly installments in the manner and on the dates as set forth in the said indenture of January 1, 1864. No resolutions declaring such dividends were adopted by plaintiff's Board of Directors during such years.

7. The plaintiff filed its income tax return for the year 1931 on March 12, 1932, reporting as its income for that year the sum of $105,000, being the amount of dividends for that year paid to its stockholders by the Alton Company (and its predecessor). The resulting tax, amounting to $12,600 was paid by the Alton Company during the year 1932. On November 22, 1933 an additional assessment of $1512 was proposed by the Internal Revenue Agent in Charge at Baltimore, Maryland, on the theory that the amount of tax so paid for the plaintiff by the Alton Company constituted additional taxable income to the plaintiff, and on January 8, 1934 such additional tax of $1512, to-

gether with interest of $160.50 (said amounts having been assessed by the Commissioner of Internal Revenue December 22, 1933) was paid by the Alton Company for the plaintiff to J. Enos Ray, the then Collector of Internal Revenue at Baltimore, Maryland.

8. In like manner for the calendar year 1932 the plaintiff filed an income tax return on or about March 14, 1933, reporting as its taxable income for the year 1932 the
47 sum of $105,000, being the amount of dividends in that year paid to its stockholders by the Alton Company. The resulting tax of $14,437.50 was paid for the plaintiff by the Alton Company. An additional assessment of $1985.16 for the year 1932, based on the same grounds as the deficiency proposed for the year 1931, was also asserted by said letter of November 22, 1933, and together with interest at $91.62 (said amounts having been assessed by the Commissioner of Internal Revenue December 22, 1933) was likewise paid January 8, 1934 to the said J. Enos Ray by the Alton Company.

9. For the years 1933 and 1934 the plaintiff filed an income tax return on or before March 15th of the respective succeeding years reporting as its income for such years the amounts of payments to plaintiff's stockholders, and of the income tax imposed thereon. The resulting tax amounted to $16,422.66 for each of said years and was paid for the plaintiff by the Alton Company. All the payments, except of the said additional assessments, were made in quarterly installments. All of said amounts were assessed by the Commissioner of Internal Revenue. The dates and amounts of such quarterly payments, the dates the assessments were made, and the several Collectors of Internal Revenue at Baltimore, Maryland. to whom they were paid, are as follows:

Year:	Date Assessed:	Amount:	Date Paid:	Amount:	To whom paid:
1932	Apr. 1933	$14,437.50	3/15/33	$3,609.38	Galen L. Tait
			6/15/33	3,609.38	Galen L. Tait
			9/15/33	3,609.38	J. Enos Ray
			12/15/33	3,609.36	J. Enos Ray
1933	Apr. 1934	$16,422.66	3/15/34	4,105.67	J. Enos Ray
			6/15/34	4,105.67	J. Enos Ray
			9/15/34	4,105.67	Lewis H. Melbourne, Acting Collector
			12/15/34	4,105.65	Lewis H. Melbourne, Acting Collector
48 1934	Apr. 1935	$16,422.66	3/15/35	$4,105.67	Lewis H. Melbourne
			6/15/35	4,105.67	" " "
			9/14/35	4,105.67	" " " Acting Collector
			12/16/35	4,105.65	M. Hampton Magruder

The term of office of said Collector Galen L. Tait terminated on July 4, 1933; of said Collector J. Enos Ray on September 10, 1934, and of said Acting Collector Louis H. Melbourne on September 17, 1935. The said Collector, M. Hampton Magruder, was the Collector of Internal Revenue on the date of the filing of the bill of complaint herein.

10. On June 13, 1935 plaintiff filed claims for refund of the additional assessment of $1512 paid for the year 1931, and for the full amount of the taxes paid for the years 1932 and 1933, in each case with interest thereon, with the Collector of Internal Revenue at Baltimore, Maryland. The same were rejected by registered letter of the Commissioner of Internal Revenue dated June 21, 1937. Plaintiff also filed on April 27, 1936 a claim for refund of the tax so paid for the year 1934, with interest, with the Collector of Internal Revenue at Baltimore, Maryland. Such claim was rejected by registered letter of the Commissioner of Internal Revenue dated July 13, 1937. A copy of the said claim for refund for the year 1932 is hereto attached as Exhibit B, and hereby made a part hereof. Each of the other claims is substantially identical to said Exhibit B in form, and is based on the same ground.

11. During the years in question the books of the plaintiff, as well as those of the Alton Company and its predecessor, were maintained pursuant to the classification of accounts for steam roads prescribed by the Interstate Commerce Commission, in accordance with Section 20 of the Act to Regulate Commerce. Such classification requires plaintiff to maintain an account designated "Income from lease of road", and during the years in
49 question this account reflected the amount of the dividends paid by the Alton Company and its predecessor to the plaintiff's stockholders as such income, and during the years 1933 and 1934 this account also reflected the amount of income taxes thereon. Correspondingly, such classification required the Alton Company and its predecessor to maintain an account designated "Rent for leased roads", and the payments of such dividends and all the income taxes thereon assessed against plaintiff were reflected in such account. In the income tax returns filed by the Alton Company deductions were taken for the amounts paid to the plaintiff's stockholders.

12. The Alton Company has operated at a loss since its acquisition in 1931 of the railroad and properties of the

Chicago and Alton Railroad Company. Its net losses have been as follows:

1931 (July 19-December 31)	$ 595,893.34
1932	1,259,704.59
1933	43,251.31
1934	1,644,579.23
Total—	$3,543,428.47

The defendant, while agreeing that the above statement in this paragraph is true, makes such agreement for the purposes of this case only, and objects to the admissibility of the same upon the ground that it is immaterial to this cause.

Frank H. Towner,
Edward G. Ince,
Arthur D. Welton, Jr.,
Attorneys for Plaintiff.

William J. Campbell,
O. K. C. J. M.
United States Attorney.

March 1, 1940.

("Exhibit A" here follows—not copied.)

50 And afterwards, to wit, on the 13th day of May, A. D. 1940, being one of the days of the regular May term of said Court, in the record of proceedings thereof, in said entitled cause, before the Honorable Michael L. Igoe, District Judge, appears the following entry, to wit: Findings of Fact and Conclusions of Law: Filed May 13, 1940.

51 In the District Court of the United States.

* * (Captions—692-693) * *

FINDINGS OF FACT AND CONCLUSIONS OF LAW.

These causes, having been consolidated by stipulation of the parties, were tried together on March 1, 1940, before this Court. All the facts were stipulated. The Court, having heard the arguments of counsel and being fully advised in the premises, now declares and enters the following findings of fact and conclusions of law:

Findings of Fact.

I.

These are actions for the recovery of income taxes paid for the plaintiff for the years 1931 to 1934, inclusive.

II.

The plaintiff, Joliet and Chicago Railroad Company, is a corporation organized and existing under and by virtue of the laws of the State of Illinois.

III.

On January 1, 1864, the plaintiff, being then the owner of thirty-seven miles of railroad between the cities of Joliet and Chicago, in the State of Illinois, entered into an indenture with the Chicago and Alton Railroad
52 Company under which it demised and leased the same, together with all of the appurtenances thereof, unto said The Chicago and Alton Railroad Company, its successors and assigns, upon the terms and conditions contained and set forth in said indenture, a copy of which was attached to the stipulation of facts and marked "Exhibit A". Among other things said indenture provides:

And the said party of the second part (said The Chicago and Alton Railroad Company) hereby further covenants and agrees, to and with the said party of the first part (the plaintiff herein) that it, the said party of the second part, will guarantee and pay unto the holders of the shares of all the capital stock of the party of the first part, whether new or old, amounting to fifteen thousand shares, an annual dividend of seven per centum upon the par value of said shares of capital stock, and the said party of the second part further covenants and agrees that it will pay said dividend quarterly, in equal installments, on the first Monday in April, July, October and January, hereafter.

IV.

The certificates of capital stock of the plaintiff contain the following provision on the face thereof:

This Stock is limited to 15,000 Shares of One Hundred Dollars each and is issued in accordance with the 2nd

Section of the Charter of this Company; it is perpetually guaranteed a Dividend of Seven per cent for each calendar year free of Government tax, payable quarter-annually on the 1st Monday in April, July, Oct. and Jany. the payment of which is secured by a Contract of Lease with the Chicago and Alton Railroad Company of the Railroad of this Company dated 1st January, 1864, the conditions of which are irrevocable and require a deposit monthly with the United States Trust Company in the City of New York of $8,750, on account of said Dividend, and for the security of the punctual payment monthly of the above sum, 37 parts out of 257 parts of the gross receipts of the Chicago and Alton Railroad Company from the line of railroad between the Cities of Alton and Chicago, are perpetually pledged.

53

V.

The Alton Railroad Company, an Illinois corporation (hereinafter referred to as "the Alton Company") acquired title on July 18, 1931, to the railroad and properties formerly owned by said The Chicago and Alton Railroad Company, including the interest in the said thirty-seven miles of railroad, created by said indenture of January 1, 1864. Such title was acquired as assignee of the purchasers of said properties, said purchasers having acquired the same pursuant to a sale thereof ordered by this Court in proceedings in equity entitled "The Texas Company *vs.* The Chicago and Alton Railroad Company", designated as Cause No. 2940. Said The Alton Railroad Company, as such assignee, entered into possession of said properties July 19, 1931, and since that time has been in possession of and operated the same, including the said thirty-seven miles of railroad between Joliet and Chicago, Illinois.

VI.

The Alton Company, from the date of its acquisition in 1931 of said properties as aforesaid (and prior thereto its predecessor) paid to the plaintiff's stockholders during the calendar years 1931, 1932, 1933 and 1934 amounts equal to annual dividends of $7 per share ($105,000) in quarterly installments in the manner and on the dates as set forth in the said indenture of January 1, 1864. No resolutions declaring such dividends were adopted by plaintiff's board of directors during said years.

VII.

The plaintiff filed its income tax return for the year 1931 on March 12, 1932, reporting as its income for that year the sum of $105,000, being the amount of dividends for
54 that year paid to its stockholders by the Alton Company (and its predecessor). The resulting tax, amounting to $12,600 was paid by the Alton Company during the year 1932. On November 22, 1933, an additional assessment of $1,512 was proposed by the Internal Revenue Agent in Charge at Baltimore, Maryland, on the theory that the amount of tax so paid for the plaintiff by the Alton Company constituted additional taxable income to the plaintiff, and on January 8, 1934, such additional tax of $1,512, together with interest of $160.50 (said amounts having been assessed by the Commissioner of Internal Revenue on December 22, 1933) was paid by the Alton Company for the plaintiff to J. Enos Ray, the then Collector of Internal Revenue at Baltimore, Maryland.

VIII.

In like manner for the calendar year 1932 the plaintiff filed an income tax return on or about March 14, 1933, reporting as its taxable income for the year 1932 the sum of $105,000, being the amount of dividends in that year paid to its stockholders by the Alton Railroad. The resulting tax of $14,437.50 was paid for the plaintiff by the Alton Company. An additional assessment of $1,985.16 for the year 1932, based on the same grounds as the deficiency proposed for the year 1931, was also asserted by said letter of November 28, 1933, and together with interest at $91.62 (said amounts having been assessed by the Commissioner of Internal Revenue on December 22, 1933) was likewise paid on January 8, 1934, to the said J. Enos Ray by the Alton Company.

IX.

For the years 1933 and 1934, the plaintiff filed an income tax return on or before March 15 of the respective succeeding years, reporting as its income for such years the amounts of payments to plaintiff's stockholders and of the income tax imposed thereon. The resulting tax

55 amounted to $16,422.66 for each of said years and was paid for the plaintiff by the Alton Company. All the payments, except the said additional assessments, were made in quarterly installments. All of said amounts were assessed by the Commissioner of Internal Revenue. The dates and amounts of such quarterly payments, the dates the assessments were made, and the several Collectors of Internal Revenue at Baltimore, Maryland, to whom they were paid, are as follows:

Year	Date Assessed	Amount	Date Paid	Amount	To whom paid
1932	Apr. 1933	$14,437.50	3/15/33	$3,609.38	Galen L. Tait
			6/15/33	3,609.38	Galen L. Tait
			9/15/33	3,609.38	J. Enos Ray
			12/15/33	3,609.36	J. Enos Ray
1933	Apr. 1934	16,422.66	3/15/34	4,105.67	J. Enos Ray
			6/15/34	4,105.67	J. Enos Ray
			9/15/34	4,105.67	Lewis H. Melbourne, Acting Collector
			12/15/34	4,105.65	Lewis H. Melbourne, Acting Collector
1934	Apr. 1935	16,422.66	3/15/35	4,105.67	Lewis H. Melbourne
			6/15/35	4,105.67	" " "
			9/14/35	4,105.67	" " " Acting Collector
			12/16/35	4,105.65	M. Hampton Magruder

The term of office of said Collector Galen L. Tait terminated on July 4, 1933; of said Collector J. Enos Ray on September 10, 1934, and of said Acting Collector Louis H. Melbourne on September 17, 1935. The said Collector M. Hampton Magruder was the Collector of Internal Revenue on the date of the filing of the bill of complaint herein.

X.

On June 13, 1935, plaintiff filed claims for refund of the additional assessment of $1,512 paid for the year 1931, and for the full amount of the taxes paid for the years 1932 and 1933, in each case with interest thereon, with the Collector of Internal Revenue at Baltimore, Maryland. The same were rejected by registered letter of the Commissioner of Internal Revenue dated June 21, 1937. Plaintiff also filed on April 27, 1936, a claim for refund of the tax
56 so paid for the year 1934, with interest, with the Collector of Internal Revenue at Baltimore, Maryland. Such claim was rejected by registered letter of the Commissioner of Internal Revenue dated July 13, 1937.

XI.

During the years in question the books of the plaintiff as well as those of the Alton Company and its predecessor, were maintained pursuant to the classification of accounts for steam roads prescribed by the Interstate Commerce Commission, in accordance with Section 20 of the Act to Regulate Commerce. Such classification requires plaintiff to maintain an account designated "Income from lease of road", and during the years in question this account reflected the amount of the dividends paid by the Alton Company and its predecessor to the plaintiff's stockholders as such income, and during the years 1933 and 1934 this account also reflected the amount of income taxes thereon. Correspondingly, such classification required the Alton Company and its predecessor to maintain an account designated "Rent for leased roads", and the payments of such dividends and all the income taxes thereon assessed against plaintiff were reflected in such account. In the income taxe returns filed by the Alton Company deductions were taken for the amounts paid to the plaintiff's stockholders.

57 Conclusions of Law.

I.

That all the payments made during the years 1931 to 1934, inclusive, by the Alton Railroad Company or its predecessor to the plaintiff's stockholders of a seven per cent (7%) annual dividends on the stock, pursuant to the lease agreement entered into on January 1, 1864, constituted income to the plaintiff in the year in which said payments were made.

II.

That the payments by the Alton Railroad Company during the years 1931 to 1934, inclusive, of income taxes assessed against the plaintiff for those years, were in discharge of an obligation of the plaintiff and hence constituted income to the plaintiff in the year in which the payments were made.

III.

That the assessments and payment of all of the taxes in question in these actions were proper under the law and that plaintiff is not entitled to recover.

IV.

That judgment should be entered against the plaintiff and in favor of the defendant.

Enter:

Igoe,
Judge.

58 And afterwards, to wit, on the 13th day of May A. D. 1940, being one of the days of the regular May term of said Court, in the record of proceedings thereof, in said entitled cause, before the Honorable Michael L. Igoe, District Judge, appears the following entry, to wit: JUDGMENT: Entered May 13, 1940.

59 In the District Court of the United States.

* * (Captions—692-693) * *

Monday, May 13, 1940.

Present: Hon. Michael L. Igoe, District Judge.

The Court having heretofore heard the arguments of counsel and having considered the statement of facts submitted and being now fully advised in the premises finds the issues for the defendant, United States of America. Therefore It Is Considered by the Court that the Plaintiff, Joliet and Chicago Railroad Company take nothing by its aforesaid action that the defendant United States of America go hence without day.

Filed Aug. 10, 1940. 60 And on, to wit, the 10th day of August, 1940, came the Plaintiff by its attorneys and filed in the Clerk's office of said Court its certain Notice of Appeal in words and figures following, to wit:

61 APPEAL TO THE CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, FROM THE DISTRICT COURT OF THE UNITED STATES,

Northern District of Illinois,

Eastern Division.

Joliet & Chicago Railroad Company, *Plaintiff-Appellant,* vs. United States of America, *Defendant-Appellee.*	Consolidated Civil Action Nos. 692 and 693.

NOTICE OF APPEAL.

Notice Is Hereby Given that Joliet & Chicago Railroad Company, plaintiff above named, hereby appeals to the Circuit Court of Appeals for the Seventh Circuit from the final judgment entered in this action May 13, 1940.

Frank H. Towner,
Edward G. Ince,
Arthur D. Welton, Jr.,
Attorneys for Appellant, Joliet & Chicago Railroad Company,
38 South Dearborn Street, Chicago, Illinois.

64 And on, to wit, the 10th day of August, 1940, came the Plaintiff-Appellant by its attorneys and filed in the Clerk's office of said Court its certain Statement of Points in words and figures following, to wit:

65 THE DISTRICT COURT OF THE UNITED STATES. Filed Aug. 1940.
• • (Captions—692-693) • •

STATEMENT OF POINTS.

The above named plaintiff asserts, and intends to urge, that in entering final judgment herein the court erred in the following respects:

1. In concluding, as a matter of law, that all the payments made during the years 1931 to 1934, inclusive, by The Alton Railroad Company or its predecessor to the plaintiff's stockholders of a 7% annual dividend on the stock, pursuant to the lease agreement entered into on January 1, 1864, constituted income to the plaintiff in the year in which said payments were made.

2. In concluding, as a matter of law, that the payments by the Alton Railroad Company during the years 1931 to 1934, inclusive, of income taxes assessed against the plaintiff for those years, were in discharge of an obligation of the plaintiff and hence constituted income to the plaintiff in the year in which the payments were made.

3. In concluding, as a matter of law, that the assessments and payment of all of the taxes in question in those actions were proper under the law and that plaintiff is not entitled to recover.

4. In concluding, as a matter of law, that judgment should be entered against the plaintiff and in favor
66 of the defendant.

5. In failing to conclude, as a matter of law, that the indenture of January 1, 1864 effectively conveyed the fee simple ownership to the property at that time belonging to the plaintiff (and to any other property thereafter acquired) to the grantee therein named, its successors and assigns, and effectively divested plaintiff of all title thereto.

6. In failing to conclude, as a matter of law, that the indenture of January 1, 1864 also served to divest plaintiff of all control over the dividends guaranteed therein to be paid to plaintiff's stockholders, and that the said dividends are subject to tax only as income received by plaintiff's stockholders as individuals.

7. In failing to conclude, as a matter of law, that since the plaintiff owns no property and since the right

to receive dividends upon its stock is irrevocably vested in plaintiff's stockholders and not subject to plaintiff's control that the payment of such dividends to plaintiff's stockholders does not constitute the amount of such payments taxable income to the plaintiff.

8. In failing to conclude, as a matter of law, that the plaintiff was not in receipt of any income during the years 1931 to 1934, inclusive.

9. In failing to conclude, as a matter of law, that the plaintiff is entitled to refund of the amounts of income taxes paid for it subsequent to March 15, 1933 as follows:

Date of Payment:	Amount:
June 15, 1933	$3,609.38
September 15, 1933	3,609.38
December 15, 1933	3,609.36
67 January 8, 1934	1,672.50
January 8, 1934	2,076.78
March 15, 1934	4,105.67
June 15, 1934	4,105.67
September 15, 1934	4,105.67
December 15, 1934	4,105.65
March 15, 1935	4,105.67
June 15, 1935	4,105.67
September 11, 1935	4,105.67
December 16, 1935	4,105.65,

together with interest on each of said amounts from the date of payment at the rate of 6% per annum.

10. In entering judgment in favor of the defendant and against the plaintiff.

11. In failing to enter judgment in favor of the plaintiff and against the defendant for the amounts listed in item 9 above, together with interest on each of said amounts from the date of payment at the rate of 6% per annum.

Joliet & Chicago Railroad Company,
By Frank H. Towner,
Edward G. Ince,
Arthur D. Welton, Jr.,
Its Attorneys.

62 And on, to wit, the 10th day of August, 1940, came the Plaintiff-Appellant by its attorneys and filed in the Clerk's office of said Court its certain Cost Bond on Appeal in words and figures following, to wit: Filed Aug. 1 1940.

63 COST BOND ON APPEAL.

Know All Men by These Presents: That we, Joliet & Chicago Railroad Company, an Illinois corporation, as principal, and H. B. Voorhees, as surety, are held and firmly bound unto the United States of America in the full and just sum of Two Hundred Fifty Dollars ($250) to be paid to the said United States of America; to which payment, well and truly to be made, we bind ourselves, our heirs, executors, and administrators, jointly and severally, firmly by these presents. Sealed with our seals and dated this 7th day of August, in the year of our Lord one thousand nine hundred and forty.

Whereas, lately at a session of the District Court of the United States, for the Northern District of Illinois, Eastern Division, in a suit pending in said Court between Joliet & Chicago Railroad Company, plaintiff, and the United States of America, defendant, a decree was rendered against the said Joliet & Chicago Railroad Company, and the said Joliet & Chicago Railroad Company having filed its notice of appeal to the United States Circuit Court of Appeals for the Seventh Circuit in the Clerk's Office of the said District Court to reverse the decree of the aforesaid suit.

Now, the condition of the above obligation is such, that if the said Joliet & Chicago Railroad Company shall prosecute its said appeal to effect, and shall answer all costs that may be awarded against it if it fails to make its plea good, then the above obligation to be void; otherwise to remain in full force and virtue.

Joliet & Chicago Railroad Company,
By H. B. Voorhees,
Vice-President.

(Corporate Seal)

H. B. Voorhees (Seal)
As Surety.

Attest:
J. Williams,
Assistant Secretary.

Filed Aug. 10, 1940. 68 And on, to wit, the 10th day of August, 1940, came the Plaintiff-Appellant by its attorneys and filed in the Clerk's office of said Court its certain Designation of Content of Record on Appeal in words and figures following, to wit:

69 IN THE DISTRICT COURT OF THE UNITED STATES.

* * (Captions—692-693) * *

DESIGNATION OF CONTENT OF RECORD ON APPEAL.

The above named plaintiff hereby designates the following to be included in the record on appeal in the above entitled case:

1. Complaint in case 692.
2. Complaint in case 693, excepting Exhibit A thereto.
3. Answer in case 692.
4. Answer in case 693.
5. Order of March 1, 1940, consolidating cases.
6. Stipulation of facts, excepting Exhibit A thereto.
7. Findings of fact and conclusions of law.
8. Judgment.
9. Notice of appeal.
10. Costs bond.
11. Statement of points.
12. Designation of content of record on appeal.

Joliet & Chicago Railroad Company,
By Frank H. Towner,
Edward G. Ince,
Arthur D. Welton, Jr.,
Its Attorneys.

Received a copy of the above designation of content of record on appeal this 10 day of August, 1940.

Wm. J. Campbell (per E C)
United States Attorney.

70 Northern District of Illinois } ss.
Eastern Division }

I, Hoyt King, Clerk of the District Court of the United States for the Northern District of Illinois, do hereby certify the above and foregoing to be a true and complete transcript of the proceedings had of record made in accordance with praecipe filed in this Court in the cause entitled

Joliet & Chicago Railroad Company } Consolidated
vs. } Nos. 692 and 693.
United States of America.

as the same appear from the original records and files thereof now remaining in my custody and control.

In Testimony Whereof, I have hereunto set my hand and affixed the seal of said Court at my office, in the City of Chicago, in said District, this 14th day of September, A. D. 1940.

Hoyt King,
Clerk.

(Seal)

At a regular term of the United States Circuit Court of Appeals for the Seventh Circuit held in the City of Chicago, and begun on the third day of October, in the year of our Lord one thousand nine hundred and thirty-nine, and of our Independence the one hundred and sixty-fourth.

No. 7458

JOLIET & CHICAGO RAILROAD COMPANY, PLAINTIFF-APPELLANT

vs.

THE UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

Appeal from the District Court of the United States for the Northern District of Illinois, Eastern Division

And, to wit: On the tenth day of March 1941, there was filed in the office of the Clerk of this Court the opinion of the Court, which said opinion is in the words and figures following, to wit:

In the United States Circuit Court of Appeals for the Seventh Circuit

No. 7458

October Term, 1940, January Session, 1941

JOLIET & CHICAGO RAILROAD COMPANY, PLAINTIFF-APPELLANT

vs.

THE UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

Appeal from the District Court of the United States for the Northern District of Illinois, Eastern Division

March 10, 1941

Before SPARKS, MAJOR, and KERNER, Circuit Judges.

MAJOR, Circuit Judge. This is an appeal from a judgment, entered May 13, 1940, disallowing a claim to recover income taxes paid for the years 1931 to 1934 inclusive, in the aggregate amount of $50,799.98, plus interest.

On January 1, 1864, the plaintiff, being the owner of thirty-seven miles of railroad between the cities of Joliet and Chicago,

Illinois, entered into an indenture, under which it granted, demised and leased the railroad, together with all the appurtenances thereof, to the Chicago and Alton Railroad Company, its successors and assigns, without reservation, forever. The indenture contained no provision under which the tenure of the grantee therein could be terminated for failure to perform any of the covenants thereof, nor did it contain any provision for the payment of rent to the grantor. In consideration therefor, the Chicago and Alton Railroad Company obligated itself to guarantee and pay to the plaintiff's stockholders forever, in quarterly installments, an annual dividend of seven percent per share on the par value of all outstanding capital stock. For the purpose of paying such dividend it further obligated itself to deposit with the United Trust Company of New York, funds sufficient therefor. In addition to these payments, the Chicago and Alton was required to pay any and all Federal taxes that might arise because of the payment of the dividend. A statement of these guaranteed payments was printed on all stock certificates issued by the plaintiff company. The number of outstanding shares was limited to fifteen thousand, having a par value of $100 per share, so that the annual payment required was $7.00 per share, or a total of $105,000 per year. This amount, beginning in 1864, was paid every year, including the years 1931 to 1934 inclusive. In addition to that, the Chicago and Alton Railroad Company and its successor, the Alton Railroad Company, paid the income taxes of the plaintiff in the amount of approximately $16,000 for each of the years involved. During these years, no resolutions declaring dividends were adopted by plaintiff's Board of Directors.

It is the contention of plaintiff that the indenture of 1864, being a lease in perpetuity and containing no defeasance clause, effectively conveyed to the grantee therein, its successors and assigns, all right, title and interest in the property. Therefore, the plaintiff, having divested itself of all of its property absolutely and, also, all control over and right to the payments made to the stockholders by the grantee, is not, and cannot be in receipt of income, actually or constructively.

The defendant, on the other hand, without conceding that the agreement was a conveyance in fee, argues that such a construction is immaterial inasmuch as the payments were received by the plaintiff's stockholders by virtue of their stock rights, and, consequently, such money is income constructively received by the plaintiff.

The indenture of 1864 is what is commonly called a lease in perpetuity. Such an instrument, however, can effectively con-

vey a fee, if its terms are sufficiently broad to warrant such an interpretation. The interest conveyed will be determined by the habendum, for it is the purpose of this part of the instrument to define the nature and quality of the estate taken by the grantee. Jamaica Pond Aqueduct Corp. v. Chandler, 91 Mass. 159. The habendum in the present instrument is as follows:

"To have and to hold, the said above demised and leased premises, together with all the appurtenances thereof without reservation, * * * Forever, * * *"

The grantor in this instrument has parted without reservation with all interest in the property. A reading of the instrument discloses that while it is called a lease, it has none of the characteristics thereof. There is no termination of the length of time the grantee is to hold the estate, no reservation of rent, no defeasance, and no right to reenter on default by the grantee. The importance of the lack of the defeasance clause is noted in State v. Mississippi River Bridge Co., 35 S. W. 592, 596:

"* * * Since the bridge company, as against the defendant railroad company, under the ruling in the case of State v. Mississippi River Bridge Co., 109 Mo. 253, 19 S. W. 421, is held to be the owner of the bridge, by reason of the defeasance clause in the lease from the bridge company to the defendant railroad company, by reason of a lack of a similar clause in the contract entered into between the Louisiana & Missouri River Railway Company and the bridge company, the defendant railroad company, as the assignee of the Louisiana & Missouri River Railway Company, cannot now be considered t be the owner of the bridge. * * *"

The indenture in the instant case was considered in Huck, et al. v. Chicago & Alton Railroad Co., 86 Ill. 352, where the court, at page 354, said:

"We think it clear, from the corporate powers conferred by its charter, the terms of the leases and the provisions of the revenue law referred to, that the Chicago & Alton Railroad Company is, for all purposes of taxation, at least, if not for all other purposes, to be regarded as the owner of all the leased property. * * *"

Thus, there is little, if any, question that the indenture of 1864 divested the plaintiff of all right, title and interest in the property, and vested a full and indefeasible title in the grantee, its successors and assigns. Chicago, Burlington & Quincy Railroad Co. v. Boyd, 118 Ill. 73.

The defendant does not seriously contend to the contrary, but points out that the parties treated the situation as one of a lessor-lessee relationship in that they entered the payments in

question on the books as "income from lease of road" in one case and "rent for lease of road" in the other. Such entries, however, can not be termed a voluntary admission on the part of the parties because made in accord with a classification established by the Interstate Commerce Commission. (Sec. 20 of the Act to Regulate Commerce.) Under such circumstances it can not be said that their acts in this respect amount to an interpretation by the parties. The defendant further contends that the requirement that the grantee should, at its own cost and expense, keep the road in good repair and working order, is inconsistent with a fee conveyance. In view of what we have said, we are of the opinion that this isolated provision does not amount to a defeasance clause, and that it is not inconsistent with a fee grant.

Defendant further contends that it is immaterial if the indenture be construed as an outright conveyance of the property; that the payments made to the stockholders, whatever they be termed, are still income to the plaintiff because the payments are the consideration for the conveyance, and, consequently, are earned by the corporation. This contention, in our judgment, presents the real issue in controversy. The authorities relied upon by the defendant in substantiation of this position are the so-called "constructive receipt" cases. In Gold & Stock Telegraph Co. v. Commissioner, 83 F. (2d) 465, the agreement was for a term of 99 years, and the taxpayer, in case of default in payment, had the option to terminate the agreement and to resume possession of the property. The property was to be surrendered in good condition at the end of the term, and the lessee agreed to pay, as an annual rental, six per cent on the capital stock of the taxpayer direct to the stockholders of the taxpayer. The court, on page 467, said:

"* * * Had all future rentals been assigned by the lessor to the stockholders, the case would have been different from that before us. * * *"

The situation in United States v. Northwestern Telegraph Co., 83 F. (2d) 468, and Pacific & Atlantic Telegraph Co. v. Commissioner, 83 F. (2d) 469, is substantially similar, the leases being for terms of 99 years and 999 years, respectively. In the former case, the court, on page 469, said:

"* * * The liability is because the property, which belongs to whoever may be the stockholders as associates in corporate form, produces the income that passes to the recipients only as stockholders. * * *"

In Rensselaer & S. R. Co. v. Irwin, 249 Fed. 726, the agreement was a lease for 500 years, in which the lessee agreed

to pay as annual rental, interest to the bondholders, and dividends to the stockholders of the lessor, for the term of the lease. The court, on page 727, states:

"* * * The lessee from 1871 down to the present time has continued to be in possession of the lessor's properties and franchises; * * *"

The latter case, it is true, was cited with approval by the Supreme Court in Old Colony Trust Co. v. Commissioner, 279 U. S. 716, 729, but this approval was limited to the proposition that income taxes paid by a lessee for a lessor are income to the lessor. It throws no light on the question as to whether the income paid to the stockholders is income of the lessor corporation.

It is plainly evident in each of the cases relied upon by the defendant that title to the property producing the income remained in the lessor, and that the income was derived from rent paid by the lessee for the use of the property held by the lessor for the benefit of its stockholders. In the instant situation, however, the plaintiff owns no property, is without power upon default to take over the property demised by the so-called lease is not actually in receipt of income, and is without authority to require payment to it. Neither can the grantee discharge its obligation under the agreement by payment to the plaintiff—in fact the latter is without right to accept such payment.

Thus, by the terms of the indenture, the stockholders of plaintiff were made donee beneficiaries of the grantee's promise, given in consideration of the conveyance; they may sue the grantee for the sums contracted to be paid them, and the plaintiff is without power to destroy their rights in this respect. Western Union Telegraph Co. v. Commissioner, 68 F. (2d) 16. The corporations in the so-called "constructive receipt" cases were links in the income-receiving chain; the income was produced from the use of their property. In the instant case where plaintiff had long before divested itself of ownership, dominion, and control of such property, we think the chain has been broken—in fact, the link has vanished. Here the promise of the grantee inured to the benefit of the stockholders by force of the agreement. Bay v. Williams, 112 Ill. 91. The income is received by them is of negligible value. In each case control by X over the income of any further benefits that may be conferred upon them by the plaintiff. Their rights are fixed by contract rather than by their status as stockholders.

The indenture agreement of 1864 did two things—(1) it put the ownership of all the corporate assets, together with any income therefrom, irrevocably out of the hands of the plaintiff

and into the hands of the grantee, and (2) it created a contractual obligation in favor of the shareholders, definite in amount, and in their right of enforcement. By this agreement, the shareholders succeeded to all the right which plaintiff might otherwise have had to this income, and, therefore, it is their income and not that of the plaintiff, either actually or constructively.

The decision of the District Court is reversed.

KERNER, Circuit Judge.

I regret that I am unable to concur in the opinion of my associates. Their opinion lays stress and is based entirely on the status of the stockholders as third party beneficiaries and the lack of control of the corporate taxpayer over the income. The opinion seems to ignore what in my opinion is a vital factor in the conclusion to be reached, the relationship between taxpayer and stockholders. At the most, that the stockholders may sue directly as third party beneficiaries on the promisor's undertaking, is of little consequence and emphasis thereon tends only to confuse the issue. Moreover, I do not believe that the doctrine of constructive receipt is governed solely by the "control of income" test, nor is it my impression that the federal courts have been imposing tax liability with regard to that test exclusively. Apparently the majority opinion indorses the statement in Northwestern Telegraph Co. v. Wisconsin Tax Commission, 248 N. W. (Wis.) 164, 166, that "the test is control over that which is taxed." I think the Wisconsin Supreme Court's view of constructive receipt is very narrow and has not won recognition by the federal courts, Gold & Stock Telegraph Co. v. Commissioner, 83 F. (2) 465, 467.

Corporation X transfers railroad property to Corporation Y in consideration of the payment of fixed amounts ("dividends") to the stockholders of Corporation X. Let us suppose a transfer (1) by lease for 999 years, (2) by perpetual lease lacking a defeasance clause, and (3) by perpetual lease containing a defeasance clause. In each case the question is whether the amounts so paid the stockholders, which X never actually receives, constitutes income to X. In cases (1) and (3) the reversion, separated as it is from the consideration, is of questionable value. In case (2) the reversion, if any, separated as it is from the consideration, is of negligible value. On each case control by X over the income has been relinquished. See Concurring Opinion, Harwood v. Eaton, 68 F. (2) 12, 14. In each case X had control of the disposition of income and could have received it, but at the time of payment the stockholders were legally entitled to it and actually received it.

In case (1) it is conceded that X is the taxable person. Pacific & Atlantic Telegraph Co. v. Commissioner, 83 F. (2) 469. In case (2) the majority opinion holds that X is not taxable. In case (3) I believe that the majority opinion would be compelled to hold X taxable. It follows that either the law conceded to be controlling in (1) is not correct or that the law applied by the majority opinion in (2) is erroneous. Manifestly this is true, for the majority opinion turns the case mainly on the element of control over income and it is a fact that in the three cases corporate control over the income has been relinquished. It is my conclusion that the majority opinion has relied unduly on the presence or absence of a defeasance clause and hence has sacrificed substance at the altar of form.

Various theories have been advanced for the result reached in case (1) above. Rensselaer & S. R. R. Co. v. Irwin, 239 F. 739, aff'd, 249 F. 726, cert. den., 246 U. S. 671; Blalock v. Georgia Ry. & Elec. Co., 246 F. 387; West End St. Rv. Co. v. Malley, 246 F. 625, cert. den., 246 U. S. 671. The substance of the arguments used by the federal courts center around the relationship between the corporate taxpayer and its stockholders. The rationale of these opinions apply as well to cases (2) and (3) as to case (1) and the same result should be reached in each case. As stated in Gold & Stock Telegraph Co. v. Commissioner, 83 F. (2) 465, 467, "As theh lessor corporation still exists to serve its stockholders for some purposes, we think it reasonable to treat it as a link in the income receiving chain which should not be disregarded as a taxpayer." Judge Learned Hand reasons that in cases such as these, there is a necessity for disregarding the corporate entity entirely and simply regarding payments to stockholders as payments to the corporation. Concurring Opinion, Harwood v. Eaton, 68 F. (2) 12, 14–15. See also Gold and Stock Telegraph Co. case, 26 B. T. A. 914, 927; Kansas City, St. L. & C. R. R. Co. v. Commissioner, B. T. A. case promulgated November 6, 1940. Some of the courts above are also influenced in their opinions by the fear that a contrary view would open the door to future circumvention of the corporate income tax.

It is clear in our case that the rights of the stockholders to the payments of income spring from their status as members of the transferor corporation and that these payments could only have been made because the corporation was under an existing obligation to distribute earnings not required for its business. See also Raynolds v. Diamond Mills Paper Co., 60 Atl. (N. J. Eq.) 941; Dodge v. Ford Motor Co., 170 N. W. (Mich.) 668. I believe that either the payments to the stockholders should be treated as

dividend distributions, or that in thus obtaining the discharge of an obligation definitely owing to its stockholders it received something of value which can property be treated as income to it. In either event the income received by the stockholders should be treated as income of the corporation for purposes of the tax.

I believe that the judgment of the District Court should be affirmed.

A true Copy:

Teste:

And, on the same day, to wit: On the tenth day of March 1941, the following further proceedings were had and entered of record, to wit:

Monday, March 10, 1941

Court met pursuant to adjournment.

Before Hon. WILLIAM M. SPARKS, Circuit Judge; Hon. J. EARL MAJOR, Circuit Judge; Hon. OTTO KERNER, Circuit Judge.

No. 7458

JOLIET & CHICAGO RAILROAD COMPANY, PLAINTIFF-APPELLANT

vs.

THE UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

Appeal from the District Court of the United States for the Northern District of Illinois, Eastern Division

This cause came on to be heard on the transcript of the record from the District Court of the United States for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, reversed, and that this cause be, and it is hereby, remanded to the said District Court.

United States Circuit Court of Appeals for the Seventh Circuit

I, Kenneth J. Carrick, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing typewritten and printed pages contain a true copy of the opinion and judgment of this Court in the following entitled cause: Cause No. 7458, Joliet & Chicago Railroad Company, plaintiff-appellant vs. The United States of America, De-

fendant-appellee, as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In testimony whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this sixteenth day of May A. D. 1941.

[SEAL] KENNETH J. CARRICK,
Clerk of the United States Circuit Court
of Appeals for the Seventh Circuit.

U. S. GOVERNMENT PRINTING OFFICE: 1941

Supreme Court of the United States

Order allowing certiorari

Filed October 13, 1941

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

U. S. GOVERNMENT PRINTING OFFICE: 19

No. 151

In the Supreme Court of the United States

OCTOBER TERM, 1941

UNITED STATES OF AMERICA, PETITIONER

v.

JOLIET & CHICAGO RAILROAD COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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In the Supreme Court of the United States

OCTOBER TERM, 1941

No. ——

UNITED STATES OF AMERICA, PETITIONER

v.

JOLIET & CHICAGO RAILROAD COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Seventh Circuit, entered in the above cause on March 10, 1941, reversing the decision of the District Court of the United States for the Northern District of Illinois.

OPINIONS BELOW

The District Court filed no opinion. The opinions of the Circuit Court of Appeals (R. 48–55) are reported at 118 F. (2d) 174.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on March 10, 1941 (R. 55). The jurisdiction of this Court is invoked under Sec-

tion 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Respondent leased its railroad and equipment in perpetuity in consideration of an agreement by the lessee company to pay specified annual dividends to respondent's stockholders and to pay any federal income taxes imposed upon respondent because of the dividend payments. The question is whether the dividend and tax payments made by the lessee constitute income to the respondent.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set forth in the Appendix, *infra*, pp. 9–10.

STATEMENT

The facts, as stipulated (R. 30–35) and as found by the District Court (R. 35–40), may be summarized as follows:

On January 1, 1864, the respondent, an Illinois corporation (R. 36), then the owner of some 37 miles of railroad tracks between Joliet and Chicago, Illinois, and of appurtenant equipment, entered into a contract, called a Lease Agreement (R. 9–18), with the Chicago and Alton Railroad Company. Pursuant to the terms of this Lease Agreement, respondent "demised and leased" its tracks and equipment to the Chicago and Alton Railroad Company in perpetuity (R. 36). In return, the Chicago and Alton Railroad

Company agreed to guarantee and pay to the respondent's stockholders forever, in quarterly installments, an annual dividend of seven per centum upon the par value of respondent's outstanding stock (R. 36). In addition the Chicago and Alton agreed to pay any federal taxes imposed upon respondent by virtue of the payment of the dividends (R. 13).

Respondent's stock issue is limited to 15,000 shares, of a par value of $100 per share (R. 36–37). Each stock certificate contains on its face a provision setting forth the guarantee obligation of the Chicago and Alton (R. 36–37). The annual dividend which the Chicago and Alton and its successor, the Alton Railroad Company, is required to pay is $7 per share or a total of $105,000 (R. 37). This amount has been paid to respondent's stockholders every year since 1864, including the years 1931 to 1934, inclusive (R. 37). In addition, the Alton Railroad Company paid federal income taxes for respondent in the amount of approximately $14,000 for the year 1931 and of approximately $16,000 for each of the years 1932 to 1934 (R. 38–39).

Respondent filed claims for refund for the income taxes paid on its behalf for the years 1931 to 1934, asserting that it had received no income in those years and that no income taxes were due from it (R. 39). Upon rejection of the claims, two actions were instituted in the District Court (R. 2, 19), where they were consolidated (R. 30).

The District Court entered judgment in favor of the United States (R. 41), but the court below reversed (R. 55), one judge dissenting (R. 53–55).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the dividend payments made in the years 1931 to 1934 by the lessee to the respondent's stockholders and the income taxes paid during those years by the lessee for the respondent did not constitute income to the respondent.

2. In reversing the judgment of the District Court.

REASONS FOR GRANTING THE WRIT

The consistent course of decision in the circuit courts of appeals has been that where a corporate taxpayer makes a long-term lease of all of its property to another company in consideration for the payment by the lessee of stipulated dividends to the taxpayer's stockholders, the taxpayer realizes taxable income in the amount of the dividends paid. *Gold & Stock Telegraph Co.* v. *Commissioner*, 83 F. (2d) 465 (C. C. A. 2d), certiorari denied, 299 U. S. 564; *United States* v. *Northwestern Telegraph Co.*, 83 F. (2d) 468 (C. C. A. 2d); *Harwood* v. *Eaton*, 68 F. (2d) 12 (C. C. A. 2d); *American Telegraph & Cable Co.* v. *United States*, 61 C. Cls. 326, certiorari denied, 271 U. S. 660; *Blalock* v. *Georgia Ry. & Electric Co.*, 246 Fed. 387 (C. C. A. 5th); *Rensselaer*

& S. R. Co. v. *Irwin,* 249 Fed. 726 (C. C. A. 2d), certiorari denied, 246 U. S. 671; *Northern R. Co. of New Jersey* v. *Lowe,* 250 Fed. 856 (C. C. A. 2d); *West End St. Ry. Co.* v. *Malley,* 246 Fed. 625 (C. C. A. 1st), certiorari denied, 246 U. S. 671.[1] The decision in the present case is, in principle, in conflict with all of these other decisions.

The majority of the court below sought to distinguish the cases cited on the ground that they involved leases with a specified term—in one case 99 years, in another 500 years, and in a third 999 years—rather than, as here, a lease in perpetuity. The court pointed out that a lease for a specified term, however lengthy, does not transfer title to the property from the lessor to the lessee, while a lease in perpetuity, without a defeasance clause, acts as an outright conveyance. This factual distinction between the present case and the long term lease cases, above cited, was considered sufficient to justify a difference in result.

In our view, however, the distinction is one without substance. Assuming that the lease constituted a conveyance of title, the only effect is to make the payments in question payments of purchase price, or payments in the nature of ground rent, rather than payments of ordinary rental. Even if regarded as purchase price or ground rent, how-

[1] The last four cases were all cited with approval by this Court in *Old Colony Trust Co.* v. *Commissioner,* 279 U. S. 716 and in *United States* v. *Boston & M. R. Co.,* 279 U. S. 732.

ever, the payments are as much income as though they were ordinary rent, since there was no proof offered, or contention made, that they did not represent a profit.

Since it is clear that the payments constituted income, the only issue is whether respondent realized that income. And on that issue it is plainly immaterial whether the payments were made for the use and occupancy of, or for the conveyance of title to, the property. In each of the long-term lease cases cited above, the taxpayer was held to have realized income by way of constructive receipt because the payments to its stockholders were in discharge of an obligation owing to the taxpayer by the lessee and were thus made on the taxpayer's behalf. By the same reasoning, the respondent here realized income because the payments to its stockholders were in discharge of an obligation owing to it by the lessee and were thus made on its behalf. The fact that in one case the obligation arises out of a lessor-lessee relationship, and in the other out of a vendor-vendee relationship, is without tax significance.

In the present case, as in the other cases cited, the taxpayer's stockholders received payments from the lessee only because of their status as stockholders of the respondent. Any individual who ceased to be a holder of respondent's stock ceased receiving the payments from the lessee. It is apparent, therefore, that whether or not title

to the property passed, respondent must be treated "as a link in the income receiving chain" (*Gold & Stock Telegraph Co.* v. *Commissioner, supra,* at 467) and, as such, must be held subject to taxation on all payments made in its behalf. This Court has frequently affirmed that property or money does not have to pass physically through the hands of the taxpayer in order to subject him to the tax burdens incident to ownership of the income. *Old Colony Trust Co.* v. *Commissioner,* 279 U. S. 716; *United States* v. *Boston & M. R. Co.,* 279 U. S. 732. Cf. *Raybestos-Manhattan, Inc.* v. *United States,* 296 U. S. 60.

Resolution of the conflict between the present case and the cases involving long-term leases for a specified period is of considerable practical importance. There are now pending in the Bureau of Internal Revenue several cases similar to the present one in which the lease agreements are in perpetuity. Sizable sums are involved in these cases and, since the obligation to make the payments is a continuing one, the problem will recur each year. Moreover, the decision below may induce the modification of existing long-term leases into leases in perpetuity. Such modification would not substantially affect the rights of the lessor or lessee companies *inter sese,* and yet might, under the decision below, entirely relieve the lessor corporation of liability for the income tax.

CONCLUSION

It is respectfully submitted that the petition for a writ of certiorari should be granted.

FRANCIS BIDDLE,
Solicitor General.

JUNE 1941.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 22. GROSS INCOME.
>
> (a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.
>
> * * * * *

Similar provisions will be found in Section 22 of the Revenue Act of 1932, c. 209, 47 Stat. 169; and in Section 22 of the Revenue Act of 1934, c. 277, 48 Stat. 680 (U. S. C., Title 26, Sec. 22).

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

> ART. 70. *Income to lessor corporation from leased property.*—Where a corporation has leased its property in consideration that the lessee shall pay in lieu of other rental an amount equivalent to a certain rate of dividend on the lessor's capital stock or the interest on the lessor's outstanding indebtedness, together with taxes, insurance, or other fixed charges, such payments shall be considered rental payments and shall be

> returned by the lessor corporation as income, notwithstanding the fact that the dividends and interest are paid by the lessee directly to the shareholders and bondholders of the lessor. The fact that a corporation has conveyed or let its property and has parted with its management and control, or has ceased to engage in the business for which it was originally organized, will not relieve it from liability to the tax. While the payments made by the lessee directly to the bondholders or shareholders of the lessor are rentals as to both the lessee and lessor (rentals paid in one case and rentals received in the other), to the bondholders and the shareholders such amounts are interest and dividend payments received as from the lessor and as such shall be accounted for in their returns.

Similar provisions will be found in Article 70 of Treasury Regulations 77, promulgated under the Revenue Act of 1932; and in Article 22 (a)–20 of Regulations 86, promulgated under the Revenue Act of 1934.

U. S. GOVERNMENT PRINTING OFFICE: 1941

No. 151

In the Supreme Court of the United States

OCTOBER TERM, 1941

UNITED STATES OF AMERICA, PETITIONER

v.

JOLIET & CHICAGO RAILROAD COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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In the Supreme Court of the United States

OCTOBER TERM, 1941

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UNITED STATES OF AMERICA, PETITIONER

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JOLIET & CHICAGO RAILROAD COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The District Court delivered no opinion. The majority and dissenting opinions in the Circuit Court of Appeals (R. 48–55) are reported at 118 F. (2d) 174.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on March 10, 1941 (R. 55). The petition for a writ of certiorari was filed on June 10, 1941, and was granted on October 13, 1941. The jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Respondent executed a perpetual lease of its railroad and equipment in consideration of an agreement by the lessee com-

pany to pay specified annual dividends to respondent's stockholders and to pay federal income taxes imposed upon respondent by reason of the dividend payments. The question is whether dividend and corresponding tax payments by the lessee constitute income to the respondent.

STATUTES AND REGULATIONS INVOLVED

The relevant statutes and regulations are set forth in the Appendix, *infra*, pp. 9–10.

STATEMENT

The facts, as stipulated (R. 30–35) and as found by the District Court (R. 36–40), may be summarized as follows:

On January 1, 1864, respondent Illinois corporation (R. 31, 36), then the owner of 37 miles of railroad between Joliet and Chicago, Illinois, and of accessory equipment, entered into a lease agreement with the Chicago and Alton Railroad Company (R. 31, 36). By the agreement (Ex. A, R. 9), respondent "demised and leased" its road and equipment to the Chicago and Alton "forever" (R. 9, 10, 31, 36). In return the lessee agreed to pay to respondent's stockholders in perpetuity an annual dividend of seven per centum on the par value of respondent's outstanding capital stock (R. 12, 13–15, 31, 36). In addition the lessee agreed to pay all taxes which might at any time thereafter be due "on account of said dividend so paid from time to time" (R. 13).

Respondent's stock issue is limited to 15,000 shares, each share having a par value of $100 (R. 11, 12, 31–32, 36–37). The certificates of stock contain on their face a provision setting forth the obligation of the Chicago and Alton (R. 31–32, 36–37). The annual dividend is $7 per share and totals $105,000. This amount has been paid to respondent's stockholders every year since 1864, including the years 1931 through 1934, by the Chicago and Alton and its successor, the Alton Railroad Company (R. 32, 37). In addition, the Alton Railroad Company paid federal income taxes for respondent in the amount

of approximately $14,000 for the year 1931 and of approximately $16,000 for each of the years 1932 to 1934 (R. 32–33, 38, 39).[1]

Respondent filed claims for refund for the income taxes paid on its behalf for the years 1931 to 1934, asserting that it had received no income in those years and that no income taxes were due from it (R. 34, 39). Upon rejection of the claims, two actions were instituted in the District Court (R. 2, 19) where they were consolidated for trial (R. 30). The District Court entered judgment in favor of the United States (R. 41). The court below reversed (R. 55), one judge dissenting (R. 53–55).

SPECIFICATION OF ERRORS TO BE URGED

The circuit court of appeals erred:

1. In holding that the dividend payments made in the years 1931 to 1934 by the lessee to respondent's stockholders and the income taxes paid with respect to those years by the lessee for the respondent did not constitute income to the respondent.

2. In reversing the judgment of the district court.

SUMMARY OF ARGUMENT

If the agreement of respondent was a lease of its property, payments by the lessee directly to the lessor's stockholders constituted rental to the lessor and therefore income taxable to it. However, the form or measure of the lessor's transfer is not significant; if the agreement be considered as a sale by respondent, the dividend payments are profits accruing to respondent in the nature of a capital gain. The Treasury regulations, in construing successive revenue acts over a long period, have required the inclusion in corporate gross income of amounts paid directly to the shareholders of corporations in respondent's present position; that long-continued administra-

[1] The amount for each of the four years included additional taxes due with respect to respondent's income realized through discharge by the Alton Railroad Company of respondent's principal tax liabilities for the years in question.

tive construction, reinforced by successive reenactments of the statutory provisions, should govern this case. If the dividend payments to respondent's stockholders constituted income realized by respondent, federal income tax payments on respondent's behalf consequently were likewise income of the respondent corporation.

ARGUMENT

THE PAYMENTS IN QUESTION ARE EARNINGS OF THE RESPONDENT AND CONSTITUTE INCOME ATTRIBUTABLE TO IT IN THE YEARS IN WHICH THE PAYMENTS WERE MADE

Where a corporation leases or sells its property at a profit, it is of course taxable upon the income received as a result of the lease or sale.[2] If the corporation thereafter distributes such income to its stockholders, they are likewise taxable upon the dividends so received. The only question here is whether the corporate tax can be avoided when the lessee or purchaser, by arrangement, pays the rentals or purchase price directly to the corporation's stockholders.

It has long been firmly established that a corporate lessor must be treated as having received taxable income where the lessee pays the rentals to the lessor's stockholders. *Gold & Stock Telegraph Co.* v. *Commissioner*, 83 F. (2d) 465 (C. C. A. 2), certiorari denied, 299 U. S. 564; *United States* v. *Northwestern Telegraph Co.*, 83 F. (2d) 468 (C. C. A. 2) (term of 99 years); *Pacific & Atlantic Telegraph Co.* v. *Commissioner*, 83 F. (2d) 469 (C. C. A. 2) (term of 999 years); *American Telegraph & Cable Co.* v. *United States*, 61 C. Cls. 326, certiorari denied, 271 U. S. 660 (term of 50 years); *Northern R. R. of N. J.* v. *Lowe*, 250 Fed. 856 (C. C. A. 2); *Rensselaer & Saratoga R. R.* v. *Irwin*, 249 Fed. 726 (C. C. A. 2), certiorari denied, 246

[2] Gains from capital transactions are taxed as ordinary income in the case of corporations. *E. g.*, section 117 (c) (1), Internal Revenue Code; section 19.22 (A)-19, Regulations 103 (1940). The same result obtained under the Revenue Acts of 1928, 1932, and 1934, operative in this case. Sections 22 (a), 101, Revenue Act of 1928; sections 22 (a), 101, Revenue Act of 1932; sections 22 (a), 117, Revenue Act of 1934.

U. S. 671 (term of 500 years); *West End Street Ry.* v. *Malley*, 246 Fed. 625 (C. C. A. 1), certiorari denied, 246 U. S. 671 (term of 24 years); *Blalock* v. *Georgia Ry. & Elec. Co.*, 246 Fed 387 (C. C. A. 5); *Terre Haute Electric Co.*, 33 B. T. A. 975 (term of 999 years). Those decisions, however, do not depend on the formal circumstances of the landlord and tenant relationship; rather, they exemplify in a particular situation the general principle that a corporation is subject to income tax on the gains from its enterprise whether those gains pass actually through the corporate treasury or are distributed directly to the associated shareholders according to their respective interests.

Respondent urges here that the lease of 1864 amounted to a conveyance in fee of its property, with the result that the foregoing lease cases are not relevant.[3] We think it immaterial whether the transfer to the Chicago and Alton was a true lease or constituted a sale; if a lease, the dividends paid to the stockholders of respondent amount to rent received by the corporation periodically for the use of its property over an indefinitely long term.[4] If a sale by respondent, the dividends are installments of purchase price representing gain that accrues from the corporation's capital transaction.[5]

Respondent argues for a different result in the case of sale on the ground that the corporation no longer owns any property out of which the dividends could be said to arise as income. But that must always be true where there has been a sale of corporate assets. If the purchaser paid the sale price to the

[3] In view of the length of the period of lease in many of the cases, the terms were, practically, the equivalent of perpetual leaseholds.

[4] Not only has this Court declined to review several of the lower court lease cases, but has cited them with approval in *Old Colony Trust Co.* v. *Commissioner*, 279 U. S. 716, 729–730.

[5] Respondent concedes (Br. in Opp. 3) that the dividends paid to its stockholders were income rather than a return of capital (see Pet. 5–6), and states that the only question is whose income they were.

The payments reserved by the Joliet and Chicago in its perpetual lease to the Chicago and Alton closely resemble ground rent. *Cook* v. *Bayonne*, 80 N. J. L. 596; *Irwin* v. *Bank of the United States*, 1 Pa. St. 349.

corporation in installments, the profit from the transaction would clearly be taxable to the corporation. Continuing ownership of property, then, cannot be decisive of taxability. The pivotal consideration is that by reason of its dealings with its property, whether by sale or lease, the corporation became entitled to profits which it directed to be paid to its stockholders.[6]

Respondent reasons here that the 1864 transaction was in the nature of a three-party novation, by which the corporation abdicated its position, leaving only the shareholders and the Chicago and Alton as parties interested in the Joliet and Chicago property. This theory is negated by the relation which the two contracting parties, respondent and the Chicago and Alton, arranged to govern all three subsequently; respondent's stockholders received the payments as dividends on stock held by them in respondent corporation; the payments were proportional to their respective stock holdings; the right to receive payments from the Chicago and Alton was inseparable from the share rights (R. 12, 16). The position of the stockholders as stockholders in respondent is greatly superior to what it would have been in the case of a reorganization in which they received stock of the Chicago and Alton in exchange for their Joliet and Chicago shares, the latter corporation being wound up, since the stockholders' right has the status of a debt owed by the Chicago and Alton.[7] See *Rensselaer & Saratoga R. R.* v. *Irwin, supra.* Continued existence of the Joliet and Chicago Railroad as a legal entity was plainly contemplated by the parties in their provision for payment by the Chicago and Alton of salaries to specified officers of respondent (R. 16). Cf. *Gold & Stock Telegraph Co.* v. *Commissioner, supra; United States* v. *Northwestern Telegraph Co., supra.*

[6] The argument (Br. in Opp. 7) that respondent corporation has no control over or interest in payments made by the Alton Company is untenable when it is remembered that the same is true of the lease cases in this regard.

[7] It is stipulated that the Alton Company operated at substantial net losses during all of the years 1931 through 1934 (R. 34–35).

We think that in the years after 1864 respondent's stockholders received income from the Chicago and Alton by virtue of their corporate association and, therefore, that respondent corporation realized this income. *Kansas City, St. L. & Chi. R. R. Co.*, 42 B. T. A. 1163, 1171 (perpetual lease). *Raybestos-Manhattan Co.* v. *United States*, 296 U. S. 60, furnishes a helpful analogy. There corporation A sold its property to corporation B in consideration of the latter's undertaking to issue an agreed number of its shares direct to A stockholders in proportion to their holdings. Liability for federal tax with respect to *issue* of the new stock was conceded; but the Court held that there was in addition liability for a *transfer* tax on the passage of the ownership of B stock from A to A's shareholders. Thus A incurred the same tax consequences as if it had received the stock from B and then distributed it to its stockholders. And it is settled that realization of income by a taxpayer does not require actual passage of receipts into the taxpayer's hands. Cf. *Helvering* v. *Horst*, 311 U. S. 112; *Helvering* v. *Cliffo d*, 309 U. S. 331; *Douglas* v. *Willcuts*, 296 U. S. 1; *Burnet* v. *L ininger*, 285 U. S. 136; *Old Colony Trust Co.* v. *Commissi ner*, 279 U. S. 716; *United States* v. *Boston & Maine R. R.*, 279 U. S. 732.

Moreover, applicable Treasury regulations have long provided that dividend payments made by a lessee to the stockholders of a lessor corporation are taxable as income to the lessor, although the lessor may have conveyed away its property or ceased to engage in business. U. S. Treas. Reg. 45 (1918) Art. 546.[8]

If the dividend payments made by the Chicago and Alton and its successor, the Alton Railroad Company, to respondent's stockholders were income realized by respondent corporation,

[8] Corresponding provisions have appeared in the various additions of the regulations promulgated since that time. Art. 547, Reg. 62 (1921), 65 (1924), 69 (1926). These regulations, under the familiar rule, should be treated as controlling. Cf. *Helvering* v. *Winmill*, 305 U. S. 79, 82–83; *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90, 96.

it follows that the federal income tax payments made by the Alton Railroad Company for respondent were equally income taxable to respondent corporation. *Old Colony Trust Co.* v. *Commissioner, supra; United States* v. *Boston & Maine R. R., supra.*

CONCLUSION

The payments in question are earnings of the respondent and constitute income attributable to it in the years in which the payments were made. It is therefore respectfully submitted that the decision below is erroneous and should be reversed.

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NOVEMBER 1941.

APPENDIX

Revenue Act of 1928, 45 Stat. 791:

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * *

Similar provisions are contained in Section 22 of the Revenue Act of 1932, 47 Stat. 169; and in Section 22 of the Revenue Act of 1934, 48 Stat. 680 (U. S. C., Title 26, Sec. 22).

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 70. *Income to lessor corporation from leased property.*—Where a corporation has leased its property in consideration that the lessee shall pay in lieu of other rental an amount equivalent to a certain rate of dividend on the lessor's capital stock or the interest on the lessor's outstanding indebtedness, together with taxes, insurance, or other fixed charges, such payments shall be considered rental payments and shall be returned by the lessor corporation as income, notwithstanding the fact that the dividends and interest are paid by the lessee directly to the shareholders and bondholders of the lessor. The fact that a corporation has

> conveyed or let its property and has parted with its management and control, or has ceased to engage in the business for which it was originally organized, will not relieve it from liability to the tax. While the payments made by the lessee directly to the bondholders or shareholders of the lessor are rentals as to both the lessee and lessor (rentals paid in one case and rentals received in the other), to the bondholders and the shareholders such amounts are interest and dividend payments received as from the lessor and as such shall be accounted for in their returns.

Similar provisions are contained in Article 70 of Treasury Regulations 77, promulgated under the Revenue Act of 1932; and in Article 22 (a)–20 of Treasury Regulations 86, promulgated under the Revenue Act of 1934.

U. S. GOVERNMENT PRINTING OFFICE, 1941

FILE COPY

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BRIEF FOR RESPONDENT

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The sole reason advanced for granting the writ is an alleged conflict *in principle* between the court below and the cited decisions of other Circuit Courts of Appeals.

There is no conflict of decision. The petition does not and cannot show that, in its necessary effect, the decision below stands for a rule conflicting with the decisions cited. This could not be shown, because they are not conflicting decisions as to the same matter. There is nothing to indicate that the court below would not, in an appropriate case, follow the cases cited by peti-

tioner. On the face of the petition, there is no reason for granting the writ.

There can be no conflict in principle between courts whose *ultimate* criterion is the presence or absence of control over or interest in the income to be taxed or the property producing it.

The petition fails fully or accurately to present the reasoning of the decisions allegedly conflicting, and it fails fully to present the circumstances distinguishing this case from those establishing the "constructive receipt" doctrine upon which petitioner relies. Proper consideration of these matters demonstrates conclusively that there is no conflict in principle, just as there is no conflict in decision.

An attempted impression (Pet. p. 5) is that there should be no distinction in the applicable rule based merely on the length of the term of a lease. That seems correct, but has nothing to do with this case. As in mathematics, infinity carries consequences beyond the finite, however great the finite may be. A lease in perpetuity, without defeasance clause, involves legal and economic consequences unknown to a lease for a term, however long.

The first and foremost consequence is that it is not a lease at all, but a conveyance; hence the relation of landlord and tenant does not exist. Thus, the primary basis of the decisions relied upon by petitioner is found wanting in this case, for in each of those cases the right of reentry for breach of the lease remained in the lessor corporation, and the payments received by its stockholders represented earnings of the property *owned by their corporation*. That is not so in the case at bar.

Petitioner seeks to avoid the effect of this circumstance by asserting it to be a distinction without substance, and by claiming that it only changes the char-

acter of the payments from rent to payments of purchase money, or of ground rent. In either of those events, states the petition, they are as much income as though ordinary rent "since there was no proof offered, or contention made, that they did not represent a profit." (Pet. p. 6.)

To this it may be said, first, that the argument is not advanced by putting a different label on the payments involved, and second, that there could have been no object in offering proof as to an issue not raised. Petitioner's position has been consistently based on Article 70 of Regulations 74 (and similar subsequent regulations) (Pet. p. 9) which refer only to payments "in lieu of other rental." These points, however, need not be labored, because the question here is not whether the payments involved were income, but *whose* income they were.

Petitioner contends that there is no tax significance in the fact "that in one case the obligation arises out of a lessor-lessee relationship, and in the other out of a vendor-vendee relationship." (Pet. p. 6.) This is unsound because the question is not what the relationship is called but, what are the legal and economic incidents of the relationship. In the lessor-lessee relationship the courts have found a basis for tax liability against the lessor in the fact of ownership in the lessor of the property producing the income that finds its way into the hands of the lessor's stockholders. Where the vendor-vendee relationship exists this necessary chain of circumstances is absent.

It is not conceded that the relationship of vendor and vendee exists in the case at bar. It may be that the transaction of 1864 was a sale but if so it was a completed transaction at that time. The indenture then entered into effectively divested this respondent of all

interest in the payments to its stockholders, and with equal effectiveness vested those rights in the stockholders. Therefore, if it was a sale there was a complete and irrevocable assignment of the consideration in 1864. That fact cannot give rise to income tax liability against the assignor at the present time.

In the cases involving the lessor-lessee relationship, the courts have indicated clearly that they would be controlled by the effect of such an assignment, and hold the lessor not liable to income tax, were it not for the continuing ownership of the underlying fee to the leased property in the lessor, with the resulting chain of circumstances already referred to. All that the court below did was to follow the cases relied on by petitioner in so far as they were applicable, but to stop short of the conclusion of tax liability reached in those cases; because under the circumstances in this case the chain of circumstances upon which that liability is predicated is conspicuously absent. The decision is clearly right.

Petitioner contends, nevertheless, that simply because the payments are income it follows, under the decisions relied on by petitioner, that they were income constructively received by this respondent, and, therefore, taxable to it. This conclusion *might* follow if the principle of those decisions were as stated by the petition; or if the actual principle of the decisions were applicable in the circumstances of this case. It must, however, be rejected on both grounds.

To sustain its contention that there is a conflict in principle, petitioner asserts that in each of the cases cited the taxpayer was held to have realized income by way of constructive receipt, "because the payments to its stockholders were in discharge of an obligation owing to the taxpayer by the lessee and were thus made on the taxpayer's behalf." (Pet. p. 6.) Continuing, the

petition states: "By the same reasoning, the respondent here realized income because the payments to its stockholders were in discharge of an obligation owing to it by the lessee [*sic*] and were thus made on its behalf."

In this statement and suggested application of principle, the petitioner has indulged in two errors.

In the first place, the actual basis of each of the decisions is not susceptible of the simple statement advanced by petitioner: different circumstances in each case resulted in different emphasis, and only as to some of the cases can it be said that the conclusion was spelled out as petitioner suggests. Furthermore, petitioner's manner of statement practically begs the question by omitting the reason why the courts thought an obligation existed—an omission of which the courts were not guilty. That reason—existence of the lessor-lessee relationship—was the real ground of the decisions relied upon.

In the second place, petitioner overlooks the fact that in the case at bar there is neither any such obligation, nor any basis for it.

The obligation referred to is the obligation to make payments for the use of leased property in order to be entitled to such use. Such an obligation existed in each of the cases cited by the petitioner, and in each, enforcement of that obligation was sanctioned by rights of forfeiture and reentry in the lessor corporation. It was thus apparent in those cases that the lessor corporation was the owner of the property producing the income paid directly by its lessee to its stockholders. This set of circumstances is the common denominator of the constructive receipt cases, as a brief review will demonstrate.

In the *Blalock case* (246 Fed. 387; C. C. A. 5th), the court held that payment to another at the direction of a creditor (the lessor) was the same as payment to the

creditor, and that there was no difference between receipt by the corporation itself "of net income accruing from *its business or property*" (p. 390), and receipt thereof by its stockholders directly.

In the *West End Street Railway case* (246 Fed. 625; C. C. A. 1st) the court noted that the payments to the stockholders "were made by the lessee for its use of the corporation's property" (p. 626) pursuant to agreement between the lessee and "the lessor corporation *to which the property belongs*" (p. 626), the payments being expressly designated "as part of the agreed rent for the property" (p. 627). The court thought, further, that the agreed payments could certainly be recovered by the lessor, but that it was "at least uncertain" whether the stockholders could collect in their own right.

In the *Rensselaer case* (249 Fed. 726; C. C. A. 2nd), the "dividends" were also stated to be part of the rent paid for the use of the property, and, under the terms of the lease there involved, the court said that "the rent is a debt of the lessee to the lessor" (p. 727), and, therefore, the payments to the lessor's stockholders were made by the lessee "as agent of the lessor" (p. 728). The case of *Northern Railroad Co. of N. J.* v. *Lowe* (250 Fed. 856; C. C. A. 2d), was merely a *per curiam* decision, without opinion, on authority of the *Rensselaer* case.

In *American Telegraph & Cable Co.* v. *U. S.* (61 C. Cls. 326), the court held the payments to be of "rent, due primarily to the lessor, *for its property,* in which the stockholders have no direct ownership" (p. 333), and noted that on failure of the lessee to pay, the lessor "would have its legal remedies" (p. 333).

Harwood v. *Eaton* (68 F.(2d) 12; C. C. A. 2d), involved only the issue of a stockholder's transferee liabil-

ity for the lessor's income taxes. That issue was decided in favor of the stockholder. Apparently the court thought the lessor corporation was constructively in receipt of the payments made to its stockholders by the lessee, but had not constructively transferred them —or, if so, that constructive transfer was not adequate basis for stockholder's liability as a transferee. Escape from the artificiality of the constructive receipt doctrine seems to have been the objective and the attainment of this decision.

The most recent case is *Gold & Stock Telegraph Co.* v. *Commissioner* (83 F (2d) 465; C. C. A. 2d). There the court placed its decision squarely on the ground that "the stockholders remained in receipt of income which came to them, though, under the agreement, because they were not merely promisees or assignees but stockholders still availing themselves of the corporation *to hold title on their behalf*" (p. 467). And so in the companion case, *U. S.* v. *Northwestern Telegraph Co.* (83 F. (2d) 468), the same court said: "We do not think that the stockholders can avail themselves of a corporate organization to avoid the double tax, which is ordinarily imposed where income arises *from the property of a corporation* and is paid to its stockholders, without subjecting themselves to such tax liabilities as may be inherent in the relation." (p. 469.)

In the case at bar, as in the *Gold & Stock Telegraph Co. case* (83 F.(2d) 465), the respondent has neither control over nor interest in the payments made to respondent's stockholders by the Alton Railroad Company. (See *Northwestern Telegraph Co.* v. *Wisconsin Tax Comm.*, 248 N. W. 164, a decision deemed correct but not controlling in the *Gold & Stock case*). Even where the "dividends" are thus beyond the control of the lessor, the cases cited by petitioner may impose income tax

liability on the lessor corporation, but only because that corporation is availed of by the stockholders *to hold title to the property producing the income they receive.*

Since this factor was not present in this case, the court below rightly held that: "The indenture agreement of 1864 did two things—(1) it put the ownership of all the corporate assets, together with any income therefrom, irrevocably out of the hands of the plaintiff and into the hands of the grantee, and (2) it created a contractual obligation in favor of the shareholders, definite in amount, and in their right of enforcement. By this agreement, the shareholders succeeded to all the right which plaintiff might otherwise have had to this income, and, therefore, it is their income and not that of the plaintiff, either actually or constructively." (118 F.(2d) 174, 175.)

The principle to be applied is that liability for tax follows control over income, either direct or indirect. The court below found no such control and therefore did not impose the liability. That conclusion presents no conflict, either of decision or in principle.

We are unable to share petitioner's apprehension as to the practical consequence of the decision below. It is true that under it this respondent is relieved from liability for income tax, but the income involved will still be subject to corporate tax as part of the income of the Alton Railroad Company, and of course will also be taxable to the stockholders. We are surprised at petitioner's suggestion that there are several cases of this character pending. While this respondent and one other corporation standing in substantially the same relation to the Alton Railroad Company, have several cases pending, it has been respondent's impression that there are a very few if any other indentures of the type here involved in the entire country.

CONCLUSION.

It is respectfully submitted that the petition for a writ of certiorari should be denied.

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INDEX.

CITATIONS.

MISCELLANEOUS.

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PRELIMINARY STATEMENT.

In 1864 this respondent parted irrevocably with all of its property and with all right to or control over any income that it might produce. The right to the income was effectively and indefeasibly vested in its stockholders by the indenture of January 1, 1864. Thus, the case is easily distinguishable from the constructive receipt cases, and the Regulations[1] implementing their rationale, relied on by petitioner. This case falls into a different category, as indicated by the court in *Gold & Stock Telegraph Co.* v. *Commissioner*, 83 F. (2) 465, when it said, at page 467:

"Had all future rentals been assigned by the lessor

1. Art. 70, Treasury Regulations 74, promulgated under Revenue Act of 1928; Art. 70, Treasury Regulations 77, promulgated under the Revenue Act of 1932; Art. 22(a)-20, Treasury Regulations 86, promulgated under the Revenue Act of 1934.

to the stockholders, the case would have been different from that before us."

The limitations of the constructive receipt cases defeat petitioner's reliance upon them. There is no other basis for liability, and no case has gone as far the petitioner's contention here. When the fictionland of the constructive receipt cases is abandoned, the inquiry moves in to the clearer atmosphere where "common understanding and experience are the touchstones for the interpretation of the revenue laws" (*Helvering* v. *Horst*, 311 U. S. 112, 118).

Here we find ready support for the decision below. He who has no ownership of, or control over, property or the income it produces, is not subject to tax upon such income. True, the existence of the power to control income is deemed equivalent to ownership (*Helvering* v. *Horst*, 311 U. S. 112, 118; *Reinecke* v. *Smith*, 289 U. S. 172, 177; *Corliss* v. *Bowers*, 281 U. S. 376, 378), and exercise of that power may constitute taxable realization of income (*Helvering* v. *Horst*, 311 U. S. 112, 118). But a controlling factor in these cases is the relation between the donor or assignor and the property producing the income. In the absence of ownership of or control over the property or the income, no tax is due from the donor or assignor (*Blair* v. *Commissioner*, 300 U. S. 5, 12, 13; *Helvering* v. *Horst*, 311 U. S. 112, 119). The court below therefore properly concluded (118 F. (2d) 174, 177; R. 52, 53):

"The indenture agreement of 1864 did two things—(1) it put the ownership of all the corporate assets, together with any income therefrom, irrevocably out of the hands of the plaintiff and into the hands of the grantee, and (2) it created a contractual obligation in favor of the shareholders, definite in amount, and in their right of enforcement. By this agreement, the shareholders succeeded to all the right which plaintiff might otherwise have had to this income, and, therefore, it is their income and not that of the plaintiff, either actually or constructively."

STATEMENT.

Petitioner's statement is somewhat inadequate. It should be pointed out that the indenture of January 1, 1864 contained no provision under which the tenure of the grantee therein could be terminated for failure to perform any of the covenants thereof, nor did it contain any provision for the payment of rent to the grantor. The court below so found (118 F. (2) 174, 175; R. 49).

The indenture also provided with respect to the payment of the "dividends" that funds to pay the same should be deposited with the United States Trust Company of New York monthly, "each and all of which deposits so made shall be placed by the said United States Trust Company to the credit of the stockholders of the party of the first part, as a fund for the purpose of paying to said stockholders, or to their legal representatives or assigns, the dividends hereinbefore provided to be paid quarterly to them" (R. 12).

Certain matters of terminology need clarification. The indenture of January 1, 1864 is called a lease but it is not a lease. "What it was styled by the parties does not determine its character or their legal relation" (*Union Pacific Ry. Co.* v. *Chicago, Rock Island & Pacific Railway Company*, 163 U. S. 564, 582).

The indenture provides for the payment of "dividends" but these payments are not dividends (*Harwood* v. *Eaton*, 68 F. (2) 12, 14). They do not represent earnings of respondent or of the property it conveyed in 1864. They are payments made in fulfilment of a promise made directly to respondent's stockholder's and enforceable by them.

The promisees under the indenture are referred to as stockholders. But their shares represent none of the economic attributes of corporate shares. The value of the

shares, on the contrary, derives solely from the promise made directly to the holders of the shares by respondent's grantee and its successors.

Petitioner frequently uses the terms "lessor" and "lessee". Respondent is not a lessor and has no lessee. The issues in this case are controlled by legal rights and powers, not terminology.

The issues raised by petitioner do not controvert the principles urged by respondent so much as they seek to challenge their application. We shall first outline briefly the principles upon which we rely, and then discuss the fallacies in petitioner's argument.

SUMMARY OF ARGUMENT.

The indenture of January 1, 1864, being a lease in perpetuity without defeasance clause, effectively conveyed fee simple title to the grantee therein named, its successors and assigns. That indenture also effectively divested this respondent of all interest in or control over the payments undertaken to be made to the holders of this respondent's shares. It effectively vested the right to the payments in such holders as third party beneficiaries. Thus, the generating source of the right to the payments is the promise contained in the indenture of January 1, 1864, not the fact that the promisees are identified as the holders of respondent's shares. That identification is purely a matter of convenience. The machinery provided in the lease for deposits with a Trustee for the account of the holders of the shares, their legal representatives and assigns, indicates that the corporate existence of respondent is unnecessary for the preservation of the rights of the third party beneficiaries.

The constructive receipt cases have based liability for tax upon the circumstance that in those cases there was no absolute assignment of income to the stockholders, and that title and the consequent sanction of forfeiture continued in the lessor corporation, whose stockholders received the income from the property it still owned. The limitations in these cases themselves prevent their applicability to the case at bar. Under general principles of tax law, liability for tax cannot attach to an assignor of income unless the assignor still has some interest in or control over the property producing the income or the income itself. Neither statute nor regulation can by fiat declare that that which is in fact the income of A shall be taxed as the income of B. The decision of the court below was correct and should be affirmed.

ARGUMENT.

I.

The Indenture of January 1, 1864 Effectively Conveyed a Fee Simple Title to the Grantee Therein Named, Its Successors and Assigns.

A lease in perpetuity, containing no defeasance clause, conveys a fee simple title. This proposition, which was concurred in by the court below, is not challenged by petitioner. It is sustained by ample authority: *Jamaica Pond Aqueduct Corporation* v. *Chandler*, 91 Mass. 159, 167-168; *DePeyster* v. *Michael*, 6 N. Y. 467, 497; *State* v. *Mississippi River Bridge Company*, 134 Mo. 321, 336; 35 S. W. 592, 596; *Walsingham's Case*, 2 Plowden, 547, 557; *Van Rennsselaer* v. *Hayes*, 19 N. Y. 68, 76; *Wells* v. *Savannah*, 87 Ga. 397, 400, 13 S. E. 442, 443; *Penick* v. *Atkinson*, 139 Ga. 649, 652, 77 S. E. 1055, 1057; *Atkinson* v. *Orr*, 83 Ga. 34, 9 S. E. 787; *Hudson Tunnel Company* v. *Attorney General*, 27 N. J. Eq. 573, 578; *Ocean Front Improvement Co.* v. *Ocean City Gardens Co.*, 89 N. J. Eq. 18, 25, 103 Atl. 419, 421; *Kavanaugh* v. *Cohoes Power Light Corporation*, 187 N. Y. Supp. 216, 231; *Wallace* v. *Harmstead*, 44 Pa. 492, 495; *Hill* v. *Atlantic Railroad*, 143 N. C. 539, 567, 55 S. E. 854, 864; *Huck, et al.* v. *Chicago & Alton Railroad Co.*, 86 Ill. 352, 354; *Wiggins Ferry Co.* v. *O. & M. Ry. Co.*, 94 Ill. 83, 93; *Chicago, Burlington & Quincy Railroad Co.* v. *Boyd*, 118 Ill. 73, 75, 7 N. E. 487, 488.

This effect of the indenture of January 1, 1864 is no vagary of Illinois law, but is a rule of property applied universally, in Illinois and elsewhere. The decisions of the state courts in regard to property rights and the effect of conveyances executed within the state relating to property situated therein, are controlling. (*Tyler* v. *U. S.*, 281 U. S.

497, 501; *Frueler* v. *Helvering*, 291 U. S. 35, 45; *Blair* v. *Commissioner*, 300 U. S. 5, 10.)

The significance of this factor in the case at bar cannot be overestimated. It cuts the last thread of ownership; it means that the respondent is without that sanction of forfeiture, which is a right that a lessor may exert to enforce compliance with a lease. It means that there is no underlying title in respondent to the property producing the income that goes to its stockholders. It means that there is no remedy for any breach of the indenture of January 1, 1864, except a suit to compel the payments therein stipulated to be made to the third-party beneficiaries of that indenture.

II.

The Indenture of January 1, 1864 Vested All Right to Payments of Dividends in Respondent's Stockholders, and Divested Plaintiff of Any Right to, or Control Over, Such Payments.

The indenture provides that:

> "The said party of the second part [the grantee] will guarantee and pay unto the holders of the shares of all the capital stock of the [respondent] * * * an annual dividend of seven percentum, upon the par value of said shares of capital stock * * *." (R. 12.)

Respondent is as devoid of any rights to or interest in the dividends which the grantee under said indenture guaranteed to pay to plaintiff's stockholders as it is devoid of any right to or interest in the property or the line of railroad which it demised under said indenture.

This point is so ably and completely discussed by the Supreme Court of Wisconsin in the case of *Northwestern Telegraph Co.* v. *Wisconsin Tax Commission*, 212 Wis. 219, 248 N. W. 164, that we quote from it at some length. In that case the lease involved was for a term of ninety-nine

years, and the lessor had the right to forfeit the lease in the event of breach by the lessee. It was, of course, a true lease, and title remained in the lessor. The lessee's obligation, however, was to pay dividends directly to the stockholders of the lessor under provisions substantially like those in the indenture involved in the case at bar. The court said (212 Wis. 225, 248 N. W. 166):

> "The control over the income is fixed in the stockholders of the appellant beyond its power to alter or interfere with * * *. In the absence of an income tax law to be taken into consideration, and there was no such tax in this state in 1881, we agree with appellant's contention that, when the person against whom the tax is sought to be laid has by valid contractual arrangement, made before the income tax law was enacted, put beyond his further command, beyond the right to stop payment, rentals to accrue, and has by solemn contract made the right to those rentals to exist in other persons, as vested property rights, then those rights cannot be changed or impaired without such third party's consent, and such rentals can be lawfully taxed as income only to those who beneficially own them, have control over them, and possess the right to do with them as they please. *Hoeper* v. *Tax Commission of Wisconsin*, 284 U. S. 206, 52 S. Ct. 120, 76 L. Ed. 248. If private property is to remain as an institution, rights under a contract must be beyond direct or indirect attack. The rights of individuals to the control over the income from the rental of appellant's property were fixed under a contract, the legality and full protection of which was not questioned in any way for upwards of fifty years, and which complies with all requirements of a legally sufficient agreement. We therefore conclude that a valid and enforceable agreement was entered into July 1, 1881, divesting the appellant of all control over the income as it accrues, and, so long as it is paid out of the revenues arranged for in the lease, that the only incomes arising out of the circumstances presented by this case are incomes flowing to the stockholders as individuals. The

> appellant has no use of its property, it can have no use of the rentals during the life of the lease. The only way that rental can be taxed is as income of the individuals to whom the lessee is bound to pay, so long at least as no default occurs. The rent being by the agreement solely the property of the stockholders and belonging to no one else, it is difficult to see how the amount assessed can be raised by appellant."

The decision of the Wisconsin court was predicated upon conclusions that under the Wisconsin law the contractual right existing in favor of a third party beneficiary of the contract cannot be altered without his consent, and that this right cannot be changed or modified by either of the original parties to the contract without the agreement of the individuals who are the third party beneficiaries. The Wisconsin court had already concluded that the lessor could not collect the payments to be made to its stockholders because the right to those payments was vested in the stockholders; and that the interest of such stockholders is not derivative, but is that of a third-party beneficiary of a valid contract. (212 Wis. at p. 224, 248 N. W. at p. 165.)

It is undoubtedly true that such questions are in this case controlled by the law of Illinois. But in fact these principles of law of contract are of general application. For instance, the Restatement of the Law of Contracts recites (Section 142):

> "Unless the power to do so is reserved, the duty of the promisor to the donee beneficiary cannot be released by the promisee or affected by any agreement between the promisee and the promisor."

As was said by the Supreme Court of Illinois in the case of *Webster* v. *Fleming*, 178 Ill. 140, 145, 52 N. E. 975, 977, in quoting and adopting the principle as previously announced in *Bay* v. *Williams*, 112 Ill. 91, 96, 1 N. E. 340, 342:

> " 'It has ever been held by this court, that such a

promise inures to the benefit of the person for whose benefit it is made, and the right to sue is vested in him by force of the agreement itself.' "

And in *Western Union Tel. Co.* v. *Commissioner*, 68 Fed. (2d) 16, a case in which a lessee guaranteed payment of dividends to the lessor's stockholders, the court said (at p. 17):

> "* * * the shareholders of the lessor are donee beneficiaries of the lessee's promise; they may sue Western Union for the sums agreed to be paid to them; the lessee has no right to require rent to be paid to itself, and could not by arrangement with the lessee destroy the rights of the shareholders without their consent."

We think the point need not be labored. The conclusion of the Wisconsin Supreme Court in the *Northwestern Telegraph Company* case was accepted as correct, but not controlling, in the case of *Gold & Stock Telegraph Co.* v. *Commissioner*, 83 Fed. (2d) 465, the last of the line of decisions establishing income tax liability on the basis of income constructively received in lessor-lessee cases. In that case Judge Augustus N. Hand said of the *Northwestern Telegraph Company* case (83 Fed. (2d) at p. 467):

> "Its decision was placed upon the ground that the rights of the stockholders in the rentals were fixed by agreement of the parties and beyond the control of the lessor corporation. *While that is true*, the stockholders remained in receipt of income which came to them, though, under the agreement, because they were not merely promisees or assignees but stockholders still availing themselves of the corporation *to hold title on their behalf.*" (Italics supplied.)

III.

A Corporation Which Neither Owns Nor Controls Any Property, Nor Has Any Right to or Control Over Any Income, Cannot Be in Receipt of Income, Constructively or Otherwise, Nor Subject to Income Tax Thereon.

The transaction evidenced by the indenture of January 1, 1864 stripped the stockholders of that corporation of every attribute then pertaining to their stock, except the right to vote for directors. The ownership of stock in a corporation ordinarily carries with it three principal perquisites—the right to a voice in the management; the right to participate in surplus profits when distributed; and the right to participate in the distribution of net assets in the event of dissolution.

The absolute conveyance of the respondent's properties on January 1, 1864, and the terms of the indenture effecting that conveyance, terminated all of these rights. Thenceforth the management of the property would be in the owner thereof. There could be no further earnings because the consideration for the conveyance was the promise of the grantee to pay to the third-party beneficiaries certain amounts designated by the term "dividends". Obviously a dissolution of respondent could result in no distribution of assets because the assets had all been transferred. If the payments promised by the indenture be deemed an asset received in exchange for the conveyance of the physical properties, the right to those payments was vested indefeasibly in the third-party beneficiaries.

The only function left for respondent corporation is the maintenance of a stock transfer book. This appears to be a superfluous function because under the indenture the payments in fact are made to a trustee for the stockholders, which is to hold the payments as a fund "for the

purpose of paying to said stockholders, *or to their legal representatives or assigns*" (R. 12) the "dividends" provided for in the indenture.

While it may be conceded that the indenture apparently contemplated the continued existence of respondent as a corporation (provisions made for nominal salaries of officers (R. 16)) there is no requirement to this effect. There is no necessity for the declaration of a dividend by this respondent, a circumstance that was present in *Terre Haute Electric Co.* v. *Commissioner*, 33 B. T. A. 975. There is no requirement that a holder of respondent's shares must be a *registered* holder, as was the case in *Blalock* v. *Georgia Ry. & Electric Co.*, 246 Fed. 387. Indeed, the very language of the indenture vests the right to the payments in the representatives and assigns of the shareholders.

Indeed, it would have been in no way inconsistent with the controlling indenture if The Chicago & Alton Company had in 1864 issued to the then holders of respondent's shares transferable certificates evidencing the right of those holders to receive the payments provided for under the indenture. Respondent could have been dissolved without any injury to the rights of the third party beneficiaries under the indenture. The situation that prevails today is exactly the same in substance as the situation that would have been created by such an arrangement. It is clear that in the supposed situation there could be no claim of constructive receipt of income by a corporation dissolved in 1864. By the same token there can be no proper claim of that character with respect to this respondent. There is nothing to indicate that this respondent's corporate existence is necessary for the preservation of the rights of the third party beneficiaries of the indenture of January 1, 1864. The indenture itself states that the obligation is to the holders of the shares and, through the Trustee, for those holders and their legal representatives and assigns.

It is equally apparent that this respondent could not demand payment to it of the payments provided for its stockholders. Similarly, payment to this respondent would not discharge The Alton Railroad Company of its obligation under the indenture.

In short, the transaction of January 1, 1864 divested this respondent's stockholders of every economic benefit that might accrue to them *as such stockholders*. In consideration thereof, the stockholders accepted the promise of the original grantee under that indenture (and its assigns) to make certain payments to a trustee for them. This is tantamount to an assignment, complete in 1864, of the right to these payments. It was made as part of a transaction in which respondent parted with its property and the management thereof, and made it certain that by no act of its own would it ever be able to engage in business or earn money.

The cases sustaining tax liability where the ordinary relationship of lessor and lessee exists cannot be controlling in such a situation. The theory of constructive receipt should be sparingly used in strong cases. It may be doubted that the constructive receipt cases relied on here may be so characterized; certainly they have stretched the theory to its last limit.

In each of the cases of this group cited by petitioner there was in fact a lease, and there was in fact a right in the lessor to enforce its provisions under threat for forfeiture. In their development of this tangential growth of the constructive receipt doctrine, the cases came to rely more and more upon the circumstance that the underlying title to the property producing the payments in question was in the corporation whose stockholders received the payments.

The evolution of the theory of constructive receipt, as applied in the lessor-lessee cases, began with the Corpora-

tion Excise Tax Act of 1909. (36 Stat. 11) In several cases arising under that law it was held that a lessor corporation was constructively in receipt of income under leases which were in fact leases. In every case title to the leased property was in the lessor. It is implicit in all of those decisions that a factor necessary to the conclusions was ownership by the lessor corporation of the property producing the income. In some of the opinions this is explicitly stated. For example, in *Houston Belt & Terminal Ry. Co.* v. *U. S.*, 250 F. 1, the court said (p. 3):

> "The title to the Terminal properties and the ownership of them was in the Terminal Company [the lessor]. * * *"

and emphasized that the payments made were the consideration for the use by the lessees of the property of the Terminal Company (p. 5).

In *West End Street Ry. Co.* v. *Malley*, 246 F. 625, the court said (at p. 626) that the "payments made were made by the lessee for its use of the corporation's [lessor's] property."

With variations required or suitable to each set of circumstances, the subsequent decisions have in general followed the lead originally indicated by these earlier cases under the 1909 Act. The most recent case which summarizes and seems largely to have settled the law is *Gold & Stock Telegraph Co.* v. *Commissioner*, 83 F. (2d) 465 (certiorari denied, 299 U. S. 564).

Brief consideration of the statements made in the course of Judge Augustus N. Hand's opinion in that case indicates conclusively that the conclusion was based on the fact of ownership of the property by the lessor.

In stating the case the court points out (p. 465):

> "In case of default in payment, the taxpayer had the option to terminate the agreement and resume possession of its property."

Again, at page 467, the court says:

> "Here the retention of the status of stockholder beneficiaries with all the rights incident to that status of sharing, in proportion to their holdings of stock, in the rentals *which the property of their corporation yielded,* subjected them to the ordinary incidents of stockholders receiving payments from the earnings of their corporation and subjected the lessor corporation to taxes upon the income of the property of the group as a corporation.
>
> • • • • •
>
> "the stockholders remained in receipt of income which came to them, though, under the agreement, because they were not merely promisees or assignees but stockholders still availing themselves of the corporation to hold title on their behalf. • • • There is no sufficient ground for abating taxes upon such groups because of the agreement that the rentals shall be paid directly to the stockholders, when such rentals are *derived from the use of the corporate property.*"

In a contemporaneous case, *United States* v. *Northwestern Telegraph Co.,* 83 F. (2d) 468, the same court stated the same general proposition as follows (p. 469):

> "We do not think that the stockholders can avail themselves of a corporate organization to avoid the double tax, which is ordinarily imposed *where income arises from the property of a corporation* and is paid to its stockholders, without subjecting themselves to such tax liabilities as may be inherent in the relation."

In short, the law as formulated requires that there be ownership of the property producing the income by the corporation whose stockholders receive it. In this respect the decisions have followed general principles of tax law.

An apt analogy is found in *Blair* v. *Commissioner,* 300 U. S. 5. That case presented the question of the liability of a beneficiary of a testamentary trust for a tax upon the income which he had assigned to his children prior to the

tax years involved, and which the trustees had paid to them accordingly. The state court had determined the assignment to be vali (*Blair* v. *Linn*, 274 Ill. App. 23.) This court's analysis of the question there presented is interesting and apposite. It was said:

1. "The tax here is not upon earnings which are taxed to the one who earns them." (300 U. S., p. 11.)

So in the case at bar, so far as the earnings of the demised property are concerned, they are the earnings of the owner of that property—not the respondent, but The Alton Railroad Company.

2. "Nor is it a case of income attributable to a taxpayer by reason of the application of the income to the discharge of his obligation." (*id.* p. 11.)

So in the case at bar, no such question can arise except in relation to the income tax payments paid for respondent by The Alton Railroad Company. Such payments can be income to respondent only if it is liable for the taxes in the first instance.

3. "There is here no question of evasion or of giving effect to statutory provisions designed to forestall evasion; or of the taxpayer's retention of control. *Corliss* v. *Bowers*, 281 U. S. 376; *Burnet* v. *Guggenheim*, 288 U. S. 280." (*id.* p. 12.)

So in the case at bar, obviously an arrangement set up in 1864 can in no sense be deemed an evasion or a prospective evasion of income tax laws that could be effectively promulgated only after adoption of the Sixteenth Amendment to the Federal Constitution in 1913. With equal obviousness it is clear that respondent has retained neither control over the property it demised in 1864 nor over the earnings therefrom.

4. "In the instant case, the tax is upon income as

> to which; in the general application of the Revenue Acts, the tax liability attaches to ownership." (*id.* p. 12.)

So in the case at bar, the frail fiction of constructive receipt must find support, if it can, in ownership by the respondent of the property it demised by the indenture of January 1, 1864. It has already been shown that such support is utterly illusory. Lacking this essential factor, the fiction must fall.

We do not have in the case at bar a question of assignment of income without a segregation of the property producing the income. An apt analogy is found in *Nelson* v. *Ferguson*, 56 F. (2d) 121 (CCA3; certiorari denied 286 U. S. 565). There a patentee transferred his patent in consideration of a promise by the transferee to pay him one-third of the profits resulting from its exploitation. Thereafter he assigned the right to the one-third share in the profits to his wife. It was held that the income was taxable to his wife, the assignee, "not to the assignor who had ceased to own or control it." (*id.* p. 124.)

This court's comment on *Blair* v. *Commissioner*, *supra*, in *Helvering* v. *Horst*, 311 U. S. 112, 119, seems decisive:

> "Unlike income thus derived from an obligation to pay interest or compensation, the income of the trust was regarded as no more the income of the donor than would be the rent from a lease or a crop raised on a farm after the leasehold or the farm had been given away."

An interesting consideration is suggested by *Helvering* v. *Clifford*, 309 U. S. 331. There the question presented was whether or not the grantor of a five-year trust under which he named himself trustee (with almost unlimited discretionary powers), and his wife the income beneficiary, was nevertheless liable for taxes upon the income thereof. This court concluded that

> "The short duration of the trust, the fact that the

wife was the beneficiary, and the retention of control over the corpus by respondent all lead irresistably to the conclusion that respondent continued to be the owner for purposes of Section 22(a)." (309 U. S., at p. 335.)

In reaching this conclusion the issue was defined to be

"whether the grantor, after the trust has been established, may still be treated, under this statutory scheme, as the owner of the corpus. See *Blair* v. *Commissioner*, 300 U. S. 5, 12." (309 U. S. at p. 334.)

This court said further that

"In absence of more precise standards or guides supplied by statute or appropriate regulations the answer to that question must depend on an analysis of the terms of the trust and all the questions attendant on its creation and operation. And where the grantor is the trustee and the beneficiaries are members of his family group, special scrutiny of the arrangement is necessary *lest what is in reality but one economic unit be multiplied into two or more*, by devices which, though valid, under state law, are not conclusive so far as Section 22(a) is concerned." (*id.* at pp. 334, 335.)

The case at bar presents the converse. In the *Clifford* case the taxpayer had sought to split his economic personality by creation of a temporary trust. In the case at bar, the indenture of 1864 effectively fused what had been theretofore two economic units into one. And insofar as the property theretofore owned by the plaintiff is concerned it has ever since been a part of what is obviously an economic unit, the Alton Railroad System.

It is no more open to the government to attempt to split one economic unit into two for the purpose of collecting taxes than it is open to a taxpayer to split his economic "person" for the purpose of avoiding taxes. To do so in this case would be "to exalt artifice above reality." (*Gregory* v. *Helvering*, 293 U. S. 454, 470.)

The substance of the situation presented by the case at bar is that the property demised by the plaintiff in 1864

belongs to The Alton Railroad Company as successor to the original grantee thereof. The economic unit is the Alton Railroad system, which has long been recognized as such. The earnings of the demised property resulting from its operation by that company are taken into the accounts of the operating company. That is the economic unit actually involved. It makes the income from its operation, it receives the income, and it pays it out.

Common understanding and experience would certainly indicate that the earnings of the demised property, if any there be, should be deemed a part of the gross income of the corporation which owns the property—namely the Alton Railroad. True, for the years in question this company had no net taxable income (R. 35) but those were years of severe depression. The position urged by respondent and sustained by the court below means only that liability for tax will be placed where it should be; and that in periods of severe depression the Alton Railroad Company, a corporation whose business is affected with a public interest, would not be burdened by tax exactions based upon vestigial fictions. This result would in fact be "the taxation of income to those who earn or otherwise create the right to receive it and the benefit of it when paid." (*Helvering* v. *Horst*, 311 U. S. 112, 119.)

"That which is not in fact a taxpayers income cannot be made such by calling it income." (*Hoeper* v. *Tax Commission*, 284 U. S. 206, 215.) Insofar as the regulations relied upon here seek by fiat to classify the payments made to respondent's stockholders as income to respondent, they are obviously unconstitutional and void as they violate the due process clause of the Fifth Amendment.

IV.

In reply to petitioner's argument: The payments in question are not earnings of the respondent and do not constitute income attributable to it in the years in which the payments were made.

At the outset of its argument petitioner cites the constructive receipt cases, saying (Pet. br. p. 5) that those decisions "do not depend on the formal circumstances of the landlord and tenant relationship." They may not depend upon the *formal* circumstances, but they do depend upon the fact that the landlord and tenant relationship did exist, and the consequent fact that the lessor corporation was used by its stockholders to hold the titie to the property producing the income which they received directly.

Petitioner would have it that the only difference resulting from the fact that the indenture of January 1, 1864 conveyed the fee to respondent's property, rather than leased that property, is that the payments made under the indenture are on account of purchase price rather than rental. (Pet. br. p. 5.) But the salient fact is that the indenture divested this respondent both of its property and of its right to receive income. So far as this respondent is concerned, the transaction was irrevocably completed when made, and by it the beneficiaries of the contract became indefeasibly vested with a right, enforceable by them directly, to receive the payments provided for by the indenture. Furthermore, a lessor under a long term lease has the sanction of forfeiture—a legal right of value for which the lessor corporation is still maintained by its stockholders.

It may be true, as petitioner urges at page 6, that continuing ownership of property is not decisive of taxability. But it has been decisive on the question of taxability in the constructive receipt cases upon which petitioner relies.

In the cases involving the gift or assignment of income, it is decisive. As this court said in *Helvering* v. *Horst*, 311 U. S. 112, 119, in discussing *Blair* v. *Commissioner*, 300 U. S. 5:

> "Unlike income thus derived from an obligation to pay interest or compensation, the income of the trust was regarded as no more the income of the donor than would be the rent from a lease or a crop raised on a farm after the leasehold or the farm had been given away."

Petitioner says, however (p. 6), that by reason of its dealings with its property, respondent "became entitled to profits which it directed to be paid to its stockholders". It should be noted that, so far as section 22 of the Revenue Act of 1928 (45 Stat. 791) and the similar provisions of subsequent acts are concerned, the only possible definition therein which is applicable in the case at bar is that relating to "dealings in property." So far as this respondent is concerned, its "dealing" with its property was completed in 1864.

But, the petitioner asserts, that by reason of its dealings the corporation became entitled to profits which it directed to be paid to its stockholders. We think this statement inaccurate. It may be fair to say that in negotiating the transaction this respondent could have been entitled to the payments. It may be fair to say that it exercised the power to transfer that right to its stockholders. But if so, that was done, and completely done, in 1864. And that is not a transaction that can give rise to liability for income tax seventy-five years later. This respondent received, in 1864, all that it was ever going to receive—its grantee's promise to its stockholders and their assigns.

Petitioner's footnote (6) (p. 6), asserts that "the argument that respondent corporation has no control over or interest in payments made by the Alton Company is untenable when it is remembered that the same is true of the lease cases in this regard." The significance of our ob-

servation is that where, in the lease cases, it was true that there was no control over the payments, the courts relied alone upon the fact that the corporation was used to retain the title to the income producing property. That ground does not exist in the case at bar. And in *Gold & Stock Telegraph Co.* v. *Commissioner*, 83 F. (2d) 465, the court was at pains to point out (at p. 467) that a difference would exist if there were an absolute assignment of income to the stockholders.

We do not contend, as petitioner asserts (p. 6), that the 1864 transaction left only the shareholders and the Chicago & Alton as parties interested in the Joliet & Chicago property, unless by "property" petitioner means not only the physical property transferred in 1864 but also the right to the payments undertaken by the Alton Company. The latter company owns the physical property; the payments under the indenture are the only economic right that the stockholders of this respondent have.

Petitioner next asserts that respondent stockholders received the payments as "dividends on stock". It is true they are so denominated. But they have no relation to earnings, and they are not dividends in fact. (cf. *Harwood* v. *Eaton*, 68 Fed. (2), 12, 14.) Petitioner also urges that the right to receive the payments is inseparable from the share rights. But the shares represent no other right of economic value. And the assertion of inseparability is negated by the provision that the trustee for the stockholders to whom the payments are to be made is bound to hold them for the purpose of making the payments to the stockholders, or to their legal representatives or assigns (R. 12).

We are at a loss to understand the pertinence of the petitioner's observation that respondent's stockholders stand in a position superior to the position of a stockholder of the Alton Company, assuming a reorganization and an exchange of stock. This is obvious. The illustration suggests, however, the very apposite analogy of debenture hold-

ers. A debenture is a promise to pay, enforceable by the holder thereof. Respondent's stockholders are in exactly the position they would be in if they were owners of Alton Company debentures.

Petitioner asserts (p. 7) that respondent's stockholders received income from the Alton Company by virtue of their corporate association. This assertion must fall before the obvious fact that respondent's stockholders received the payments by reason of the contract obligation of the Alton Railroad Company. While the promisees under that contract are identified as stockholders, their rights as promisees are not generated by their status as stockholders but by the contract in their favor. In the *Gold & Stock Telegraph Co. case* (83 F. (2d) 465), relied on by petitioner, the court reached the conclusion here asserted by the petitioner only because the stockholders availed themselves of their corporation to hold title on their behalf, (cf. 83 F. (2d) at p. 467.) As already suggested, if respondent had been dissolved and the Alton Company (or the trustee of the payments) issued transferable certificates evidencing the right to receive the payments, the third-party beneficiaries would be secured in their rights; respondent would not only be dead, as it is now, but buried.

The *Raybestos case* is not a helpful analogy (*Raybestos-Manhattan Co.* v. *U. S.* 296 U. S. 60). That case involved the question of liability for transfer tax. The rationale of the decision is well put in the final sentence (296 U. S. 60, 64):

> "Here, the power to command the disposition of the shares included the right to receive them, and the *exercise* of the power which transferred the right is subject to a tax." (Italics supplied.)

So it may be conceded that this respondent in 1864 exercised its power to transfer the income to be derived from the transaction to its stockholders, but it was a complete and irrevocable exercise in 1864.

We may agree with petitioner that "it is settled that realization of income by a taxpayer does not require actual passage of receipts into the taxpayer's hands" (Pet. br. p. 7). But we do not agree that there is any such realization where the taxpayer has divested himself completely of all right to the income and to the property producing it. And that is the case at bar.

Petitioner asserts that treasury regulations have long provided that payments of the kind here involved are taxable as income, despite a conveyance of the property, and that, therefore, these regulations should control. This contention is unsound. It is in the first place a fiction,[2] and the compounding of fictions thus suggested may well result in the complete loss of rights—the rights themselves will become a fiction. The statute itself may not require A to pay a tax because of B's income, and no administrative fiat, of however long standing, can have such effect. "Treasury Regulations can add nothing to income as defined by Congress." *M. E. Blatt Co.* v. *United States*, 305 U. S. 267, 279.

Furthermore, that part of the regulation purporting to apply to a situation like the present one has never been construed. Its meaning is at best ambiguous. The regulation purports to cover a situation "Where a corporation has leased its property in consideration that the lessee shall pay in lieu of other rental an amount equivalent to a certain rate of dividend on the lessor's capital stock * * *". It is then provided that "The fact that a corporation has conveyed or let its property * * * will not relieve it from liability to the tax".

Obviously, the regulation by the first provision purports to cover a situation involving a lease of corporate property on certain terms. Is the later provision an inept way of attempting to rule that the fact that a "lease" amounts

2. Cf. Brown, Regulations and Reenactment, 54 Harvard L. Rev. 377, 388; Paul, Use and Abuse of Tax Regulations in Statutory Construction, 49 Yale L. J. 660.

to a conveyance in fee (as it does in the case at bar) shall make no difference with respect to tax liability? Or does it purport to mean that there is no difference with respect to tax liability if the corporation has made a lease (of the type indicated) of some of its property, and has conveyed the rest? We think it must be said, as in the case of *Sanford's Estate* v. *Commissioner*, 308 U. S. 39, 49: "At most the regulation is ambiguous, and without persuasive effect in determining the true construction of the statute".

Conclusion.

In conclusion it is respectfully submitted that this respondent was divested in 1864 of its property and of its right to receive or control the payments to be made to the third-party beneficiaries under the indenture of January 1, 1864, that the decision of the court below is right, and should be affirmed.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES.

No. 151.—October Term, 1941.

The United States of America, Petitioner, *vs.* Joliet & Chicago Railroad Company.	On Writ of Certiorari to the United States Circuit Court of Apppeals for the Seventh Circuit.

[January 19, 1942.]

Mr. Justice Douglas delivered the opinion of the Court.

By an indenture denominated a "lease" respondent in 1864 granted, demised and leased to Chicago & Alton Railroad Co. all of its railroad property, real and personal. The "lease" was in perpetuity upon specified terms and conditions. The Chicago & Alton Railroad Co. covenanted and agreed, *inter alia*, to guarantee and pay quarterly to the holders of the fifteen thousand shares of capital stock of respondent an annual dividend of seven per cent on the par value of the shares; to deposit with a designated depository specified monthly sums to be placed to the credit of the stockholders and to be held as a fund for the purpose of paying the dividends; to pay the dividends without any deduction for any federal tax whatsoever; to pay all taxes which may be due to the United States "on account of said dividend so paid from time to time"; and to pledge to respondent thirty-seven parts out of two hundred and fifty-seven parts of the gross receipts of the line between the cities of Alton and Chicago for the purpose of securing the performance of its various covenants. The "lease" contained no defeasance clause.

The annual dividend is $7.00 per share and totals $105,000.00. This amount has been paid directly to respondent's stockholders every year since 1864—by Chicago & Alton Railroad Co. until acquisition of the property in 1931 by the Alton Railroad Co., and since then by the latter company. The dispute here is over federal income taxes for the years 1931, 1932, 1933 and 1934. Respondent, a corporation organized and existing under the laws of Illinois, filed its income tax return for each of those years report-

ing the $105,000.00 of dividends paid its shareholders as its income. The resulting tax was paid each year by the Alton Railroad Co. In addition the latter paid each year for respondent an additional tax on the amount of the income tax on $105,000.00 on the theory that the latter constituted additional taxable income to respondent. Respondent filed claims for refund for the additional tax paid in 1931 and for all the income taxes paid on its behalf for the other years in question on the theory that the income on which those taxes were paid was not realized by it. On rejection of those claims by the Commissioner respondent instituted suit in the District Court. That court rendered judgment for the petitioner. The Circuit Court of Appeals reversed, one judge dissenting. 118 F. 2d 174. We granted the petition for certiorari because of the conflict between that decision and the governing principles of *Gold & Stock Telegraph Co.* v. *Commissioner*, 83 F. 2d 465, *United States* v. *Northwestern Telegraph Co.*, 83 F. 2d 468, and *Pacific & Atlantic Telegraph Co.* v. *Commissioner*, 83 F. 2d 469, decided by the Circuit Court of Appeals for the Second Circuit.

Respondent urges, and the court below held, that this so-called lease in perpetuity without a defeasance clause divested respondent of all right, title and interest in the property and vested a full and indefeasible title in the grantee. See *Huck* v. *Chicago & Alton Railroad Co.*, 86 Ill. 352, 354-355; *Chicago, Burlington & Quincy R. R. Co.* v. *Boyd*, 118 Ill. 73. Respondent also argues that the indenture of 1864 vested all rights to payment of dividends in its stockholders and divested it of any right to, or control over, such payments. Respondent therefore contends that a corporation which does not own or control property and has no right to, or control over, any income from the property cannot be in receipt of income, constructively or otherwise.

Such considerations do not dispose of this controversy. In *Lucas* v. *Earl*, 281 U. S. 111, this Court held that a husband's salary was taxable to him though by contract with his wife half of it vested in her when paid. Mr. Justice Holmes said (pp. 114-115): "There is no doubt that the statute could tax salaries to those who earned them and provide that the tax could not be escaped by anticipatory arrangements and contracts however skilfully devised to prevent the salary when paid from vesting even for a second in the man who earned it. That seems to us the import of the statute before us and we think that no distinction

can be taken according to the motives leading to the arrangement by which the fruits are attributed to a different tree from that on which they grew."

Precisely that approach was taken in Art. 70 of Treasury Regulations 74, promulgated under the Revenue Act of 1928. It provides in part:

"Where a corporation has leased its property in consideration that the lessee shall pay in lieu of other rental an amount equivalent to a certain rate of dividend on the lessor's capital stock or the interest on the lessor's outstanding indebtedness, together with taxes, insurance, or other fixed charges, such payments shall be considered rental payments and shall be returned by the lessor corporation as income, notwithstanding the fact that the dividends and interest are paid by the lessee directly to the shareholders and bondholders of the lessor. The fact that a corporation has conveyed or let its property and has parted with its management and control, or has ceased to engage in the business for which it was originally organized, will not relieve it from liability to the tax."

That long standing regulation[1] is plainly applicable here. It covers various kinds of conveyances and leases including those where the grantor or lessor has parted with all rights of management and control over the property. If valid, it governs this case whatever may be the legal incidents of the 1864 indenture under Illinois law. Its validity seems clear. It is a permissible definition of one item of gross income[2] under § 22(a) of the Revenue Act of 1928, 45 Stat. 791, 797. Payments made directly to shareholders by the lessee or transferee of corporate property are properly recognized as income to the corporation by reason of the relationship of a corporation to its shareholders. The fact that there is an anticipatory arrangement whereby the taxpayer is not even a conduit of the payments is no more significant in this type of case than it was in *Lucas* v. *Earl*, *supra*.

The relationship between respondent and its shareholders is an abiding one. They obtain the dividend payments because of their status as shareholders. All questions of the rights of creditors aside, there can be no doubt that a corporation may normally dis-

[1] This regulation dates from Art. 80, Treasury Regulations 33 (1914 ed.). And see Art. 102, Treasury Regulations 33 (1918 ed.). Provisions similar to those quoted in the text are contained in Art. 70, Treasury Regulations 77, promulgated under the Revenue Act of 1932 and in Art. 22(a)-20 of Treasury Regulations 86, promulgated under the Revenue Act of 1934.

[2] Like definitions of gross income are contained in § 22(a) of the Revenue Act of 1932 (47 Stat. 169, 178) and in § 22(a) of the Revenue Act of 1934. 48 Stat. 680, 686.

tribute its assets among its stockholders. When it undertakes to do so, its act is nonetheless a corporate act though its shareholders receive new contractual rights enforceable by them alone against the transferee. That is to say their rights to receive the proceeds on the disposal of corporate assets are strictly derivative in origin. The fact that the consideration is made distributable to them directly over a long period of time rather than in one lump payment does not alter the character of those rights. In each case their claims to the proceeds flow from the corporation and are measured by the stake which they have in it. For the rental or purchase payments for the property conveyed by respondent could not lawfully be paid to another without its authority; and it could not lawfully dispose of them to others without the consent of its shareholders. Cf. *Raybestos-Manhattan, Inc.* v. *United States,* 296 U. S. 60. The fact that the corporation may remain in existence only to maintain a stock transfer book is immaterial. The umbilical cord between it and its shareholders has not been cut. The distribution made is in performance of the obligation owed by the corporation to them. For these reasons the regulation in question merely conforms to accepted legal theory. The conclusion that the dividend payments made to respondent's stockholders were income realized by it likewise marks no innovation in income tax law. That is indicated not only by *Lucas* v. *Earl, supra,* but also by those cases which hold that, "Income is not any the less taxable income of the taxpayer because by his command it is paid directly to another in performance of the taxpayer's obligation to that other." *Raybestos-Manhattan, Inc.* v. *United States, supra,* p. 64, and cases cited. The reach of the income tax law is not to be delimited by technical refinements or mere formalism. *Helvering* v. *Clifford,* 309 U. S. 331.

Since the dividend payments made to respondent's stockholders were income realized by it, the federal income tax on those sums which was paid by the Alton Railroad Co. was likewise income taxable to respondent. *Old Colony Trust Co.* v. *Commissioner,* 279 U. S. 716; *United States* v. *Boston & Maine R. Co.,* 279 U. S. 732.

The judgment of the Circuit Court of Appeals is reversed and that of the District Court affirmed.

It is so ordered.

Mr. Justice ROBERTS did not participate in the consideration or decision of this case.